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ABSTRACT

The Congressional hearing examined abuse, mismanagement, and fraud in student loan programs focusing on the fraudulent activities of proprietary schools. Witnesses included officials of the Department of Education including: (1) Laura F. Cavazos, Secretary; (2) Ernest C. Canellos, Student Financial Assistance; (3) John S. Haines, Debt Collection Management and Assistant Service; (4) John B. Childers, Higher Education Programs; and (4) Edward C. Stringer, General Counsel. Their testimony focused on ways to eliminate recognized discrepancies and illegalities within the federally guaranteed student loan program. (LPT)

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S. Hrg. 101-659, Pt. 4

ABUSES IN FEDERAL STUDENT AID PROGRAMS

HEARING

BEFORE THE

PERMANENT
SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

PART 4

OCTOBER 10, 1990

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Hon. Lauro F. Cavazos, Secretary, U.S. Department of Education, accompanied by John B. Childers, Deputy Assistant Secretary for Higher Education Programs, Ernest C. Canellos, Acting Deputy Assistant Secretary for Student Financial Assistance, Edward C. Stringer, General Counsel, and John S. Haines, Director, Debt Collection and Management Assistance Service, Office of Postsecondary Education 5

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ABUSES IN FEDERAL STUDENT AID PROGRAMS

WEDNESDAY, OCTOBER 10, 1990

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:35 a.m., in room SD-342, Dirksen Senate Office Building, Hon. Sam Nunn, Chairman of the Subcommittee, presiding.

Present: Senators Nunn, Levin, and Roth.

Also Present: Senators Kennedy and Exon.

Staff Present: Eleanore J. Hill, Chief Counsel; John F. Sopko, Deputy Chief Counsel; Mary D. Robertson, Chief Clerk; Alan Edelman, Counsel; Kim Wherry, Counsel; David B. Buckley, Chief Investigator; Harold B. Lippman, Investigator; R. Mark Webster, Investigator; Grace McPhearson, Investigator; Cynthia Comstock, Staff Assistant; Kimberly O'Dell, Staff Assistant; Daniel F. Rinzel, Minority Chief Counsel; Carla Martin, Minority Assistant Chief Clerk; Blaine Phillips, Minority Staff Assistant. Aaron Bayer (Senator Lieberman); Ellice Halpren-Barnes (Senator Stevens); Jack Mitchell and Linda Gustitus (Senator Levin); Michael Epp and Terry Hartle (Senator Kennedy), and Robert Shireman (Senator Simon).

[Letter of authority follows:]

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

Pursuant to Rule 5 of the Rules of Procedure of the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, permission is hereby granted for the Chairman, or any Member of the Subcommittee as designated by the Chairman, to conduct open and/or executive session hearings without a quorum of two members for the administration of oaths and the taking of testimony in connection with hearings on Abuses in Federal Student Aid Programs to be held on October 5th and 10th, 1990.

SAM NUNN,
Chairman.
WILLIAM V. ROTH, JR.,
Ranking Minority Member.

Senator NUNN. The Subcommittee will come to order.

Mr. Secretary, we welcome you this morning. We give the oath to all witnesses before the Subcommittee, so if you will hold up your right hand. Do you swear the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Secretary CAVAZOS. I do.

Senator **Nunn**. Mr. Secretary, we are pleased to have you here this morning, and I would assume that some of your other people will also be testifying. If they are going to be testifying, perhaps I should give all of them the oath at this point, too. Who will be testifying?

Secretary **Cavazos**. I think they will all be testifying.

Senator **Nunn**. All right. Let me give the oath to all of you, if you would, please stand.

Do you swear the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. **Childers**. I do.

Mr. **Haines**. I do.

Mr. **Stringer**. I do.

Mr. **Canellos**. I do.

Senator **Nunn**. Mr. Secretary, I have an opening statement this morning, and then we'll hear from you.

OPENING STATEMENT OF SENATOR NUNN

Senator **Nunn**. With the appearance this morning of the Secretary of Education, Secretary Cavazos, the Permanent Subcommittee on Investigations brings to a close our year-long examination of problems in the Federal student financial aid programs.

When we launched this investigation late last year, in response to the Office of Management and Budget and General Accounting Office findings that Federal student loan programs were particularly vulnerable to fraud, waste and abuse, neither I nor, I suspect, other members of the Subcommittee believed that we would find problems as extensive and as severe as those that have surfaced during the course of these hearings.

More specifically, what we found is overwhelming evidence that the Federal student loan programs, and particularly those involving trade and proprietary schools, are riddled with fraud, waste, abuse and pervasive patterns of mismanagement.

Our investigation was not confined to only one segment of these programs. To the contrary, we have examined every level of participation—schools, accrediting agencies, licensing agencies, lenders, guarantee agencies, secondary markets, and finally, the Department of Education itself. Unfortunately, over the span of all these hearings, we did not hear of even a single major component of the guaranteed student loan program that is working efficiently or effectively.

Just to briefly summarize this morning what we have found over the last year, witnesses described case after case of unscrupulous proprietary schools that victimize students by enticing them with promises of bright futures and high pay, providing them little or no legitimate training, and ultimately leaving them with nothing but huge Federal debts that they cannot repay.

Schools like this are apparently continuing to flourish, fueled by the free flow of huge amounts of Federal student loan funds and the near total absence of any effective Federal oversight of these funds. One former Department of Education official testified before our Subcommittee that these schools, in his words, "sold seats" and little else to unsuspecting students while their owners reaped huge profits, all at the expense of the taxpayer.

We heard testimony that the "triad" system of regulation—namely, accreditation by private agencies, licensing by State agencies, and certification by the Department of Education—has failed miserably in protecting Federal funds from being continually looted by fraudulent and unscrupulous schools. We saw example after example of worthless schools that had, without any hesitation, been licensed and accredited and, as a result, certified by the Department of Education without question and without any meaningful independent review.

Faced with growing numbers of proprietary schools and often inadequate staff resources, accrediting and licensing agencies have no incentive to aggressively police the fate of Federal student aid funds in which they have no interest. Moreover, they are trained in education, not investigative law enforcement, and they are simply in many cases no match for the slick con artists and the blatantly fraudulent practices that they use in manipulating the student loan programs. To wit, one former school owner, currently in prison for defrauding the programs, described the efforts of an accrediting agency to examine his school as "laughable."

We have also heard testimony that some of the financial players—lenders, guarantee agencies, secondary markets, and loan servicing operations—have tried to turn an easy profit at the expense of Federal student loan programs, only to get caught up in major financial fiascos resulting in part from the huge volumes of loans they generated and the very rapid growth of their business.

The student loan programs, with the full-scale entry of proprietary schools in the 1970's and increasingly in the 1980's, have become big business. From schools to lenders to secondary markets, there are a host of players that see the student loan program as a low-risk and often no-risk way to make money in a big way.

There is one notable exception in this money-making scheme, and that is the taxpayer, whose interests seem to be increasingly lost in the shuffle and, I might add, the students, by the tens of thousands, who are being deprived of educational opportunities and in many cases disillusioned to the point of basically dropping out of the quest for skills and for being productive citizens.

Finally, we examined factors leading to the collapse of the First Independent Trust Company, so-called FITCO, at one time a leading lender of student loans. FITCO's downfall was precipitated by the volume and the speed with which it made and sold student loans. This in turn led to its failure to pay origination fees and refunds and the failure of its loan servicer to adequately service the loans. All of this occurred over a period of several years and in the absence of any effective oversight by the Department of Education, despite the fact that FITCO's collapse will now likely cost the taxpayer as well as foreign and domestic investors literally hundreds of millions of dollars.

Although I have this morning mentioned only a few specifics, our hearing record of the last year is replete with other examples of program weaknesses, inept management and outright fraud in the student loan programs. Taken together, they strongly suggest that we are quickly reaching the point of no return in the Federal student aid program. Either we take strong and probably drastic action now to correct these problems, or we face the ultimate collapse of the program. It has been an important program for tens of thousands of students, so there is certainly a good side to this program. I think it is clear that we have to rescue the program rather than discard the program.

The General Accounting Office just last week advised the Subcommittee of a statistic which underscores this point. In fiscal year 1990, more than half of the Federal cost of running the student loan program will be spent repaying defaulted loans. That figure was 10 percent in 1980; 36 percent last year, and now, over 50 percent. In other words, the major cost of the program is supposed to be the subsidies in terms of interest rates for students, but now 50 percent of the cost is in defaults.

In short, we have now reached the sad point where program funds are primarily being used not to subsidize education and training and skills for today's students, but rather to pay off bad loans from the past. And I am afraid that figure is going to rise some more before it turns around, even with good steps being taken, because of the pipeline of bad loans that are already there.

With the above in mind, let me comment on the one factor that has surfaced at every level of these programs and, as such, throughout our entire investigation, and that is the role of the Department of Education itself. In brief, it is not an exaggeration to say that we have heard no testimony or seen any documents that suggest the Department has done even an adequate job in managing and overseeing its student loan program responsibilities.

Moreover, criticism of the Department's efforts in this area is not unique to this investigation. Way back in 1975, this same Subcommittee heard testimony on student loan programs that was disturbingly similar, although admittedly in much smaller volumes back then, to that which we have heard in these hearings. The General Accounting Office over a period of many years has also repeatedly brought many of these problems to the Department's attention. Despite all of that, the programs failures seem only to have gotten worse, as default volume and cost to the taxpayers have skyrocketed.

Mr. Secretary, we welcome you here this morning in the hope that you and your Department have recognized and are recognizing past mistakes and that you can give us your views on how the Department intends to correct those mistakes and return this program to the goals for which it was originally intended: accessibility and quality in education and training for American students.

I want to thank Senator Roth, the Subcommittee's Ranking Member, who will be here in a few minutes, and the Minority staff for their cooperation and support during this entire investigation. Certainly, I want to thank the Majority staff, Eleanore Hill and all of the Majority staff, for their hard work and diligence.

I know Senator Roth shares my concerns about the future welfare of these programs and about the taxpayers and the huge losses they are suffering, but most of all about the students themselves, for their own benefit, for the benefit of their families, for the benefit of their future, and for the benefit of our Nation.

So Mr. Secretary, we are pleased to have you. You have had a very distinguished career in education—a former teacher at Texas Tech University; professor at the Medical College of Virginia; Dean at Tufts University School of Medicine; member of the science staff at the New England Medical Center Hospital in Boston; and of course, you were confirmed by the Senate on September 20, 1988.

I will let you, if you would, introduce the people who are with you this morning. Certainly, I know this is a vast program; we don't expect you to answer every detailed question—and we will have many—and we'll certainly let you have some of your staff help field those questions as we go along.

But we are pleased to have you this morning, even though the circumstances are rather bleak. We appreciate your being here, and we look forward to hearing your analysis.

TESTIMONY OF HON. LAURO F. CAVAZOS, SECRETARY, U.S. DEPARTMENT OF EDUCATION,[1] ACCOMPANIED BY JOHN B. CHILDERS, DEPUTY ASSISTANT SECRETARY FOR HIGHER EDUCATION PROGRAMS, ERNEST C. CANELLOS, ACTING DEPUTY ASSISTANT SECRETARY FOR STUDENT FINANCIAL ASSISTANCE, EDWARD C. STRINGER, GENERAL COUNSEL, AND JOHN S. HAINES, DIRECTOR, DEBT COLLECTION AND MANAGEMENT ASSISTANCE SERVICE, OFFICE OF POSTSECONDARY EDUCATION

Secretary **Cavazos**. Thank you very much, Mr. Chairman.

Let me first introduce the people here at the table.

Ed Stringer, General Counsel, is an expert on HEAF and the regulations on branching and clock-credit hours.

John Childers, is knowledgeable about accreditation and high defaults, and is Deputy Assistant Secretary for Higher Education Programs.

Senator **Nunn**. John is a familiar face to us here, and a welcome one. We have worked with him over the years.

Secretary **Cavazos**. Ernest Canellos is the Acting Deputy Assistant Secretary for Student Financial Assistance. He works in the area of default initiatives, the Inspector General's Management Improvement Reports' guarantee agency reviews, program reviews, the National Student Loan Data System, and due diligence.

And John Haines is Director, Debt Collection and Management Assistant Service, and is working mainly in the area of institutional data systems, institutional eligibility and certification, State licensure, and course-stretching.

Mr. Chairman, I have submitted for the record a rather lengthy statement, and I would like to enter it for the record. I have a brief statement to make at this time.

Senator **Nunn**. Mr. Secretary, we will put your full statement in the record without objection, but take your time. We are not in any hurry. You are our only witness today, and we will have a lot of questions, but we want you to have a chance to fully give your views, so don't feel rushed.

Secretary **Cavazos**. Fine. Thank you very much, Mr. Chairman.

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[1] See p. 59 for Secretary Cavazos' prepared statement.

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I come before you today to join with you in our mutual efforts to reform the guaranteed student loan programs. The work your Subcommittee has done and the hearings you are holding are focusing the Nation's attention on a series of abuses and flaws in the statute and longstanding management deficiencies.

Since I became Secretary, I have become increasingly aware of these problems and as I will outline later, I have taken a number of steps to address them. But much more needs to be done. The work of this Subcommittee will help us and the congressional authorizing committees to accomplish this task.

While you have been conducting these Subcommittee hearings, we have also been going through a very revealing and rather trying time, set off by the financial instability of a major guarantor, the Higher Education Assistance Foundation.

The more important point, however, is that HEAF's situation and the crisis atmosphere in which we had to resolve it—in a short period of time, I might add—were caused by the same problems that concern you: inadequate legislative authority for the Secretary to establish meaningful program controls and to eliminate wrongdoers; inadequate Federal oversight for many years, and inadequate performance by accrediting agencies, guarantors, schools and lenders. There is plenty of blame for everyone.

However, my goal and yours, I am sure, is not to dwell on the blame but on the cures.

Today I want to outline for you the management actions that we are taking and the legislative proposals we have made for immediate congressional action.

The Administration is also developing its proposals for reauthorization of the Higher Education Act. I can personally assure you that we will directly address significant reform in the loan programs.

Since their beginnings, the student financial assistance programs have played an important role in ensuring access to postsecondary education, especially for our most needy students. In fact, in fiscal year 1990, over 3 million students received help in meeting the cost of their postsecondary education through the Pell Grant Program.

In addition, over 4 million loans were provided to student borrowers. We all accept that a loan program, designed for students who may have no credit history, will result in some defaults. That is a price we are willing to pay for the benefits we gain.

Achieving quality education and stopping program abuses requires a partnership—a partnership between the Department of Education, accrediting agencies, State licensure bodies, guarantee agencies, lenders, and schools. By instituting significant improvements in the student aid system and providing appropriate performance measures to ensure accountability, we can reach these goals.

I am proud of the Department of Education's role in focusing the National debate on the quality of education. When the Department first put forth the idea that institutions might be held accountable for providing a quality education and preventing student loan defaults, opposition was strong and vocal. It was right out there—it was one of the first things I heard about—yet the Department of

Education persisted and, as this hearing indicates, the debate and focus have now shifted.

Nearly everyone agrees that more must be done to improve the quality of postsecondary education for all students. One of my first actions—actually, within a matter of a week after I came on the job—as Secretary of Education was to issue regulations that take a tough but fair approach to the student loan default situation. I started looking at it right away. The final regulations were issued on June 5, 1989. I was sworn in on September 20, 1988.

These regulations target the worst offenders with the toughest possible sanctions. Beginning next year, schools with the highest default rate may lose eligibility for Federal student aid. These schools, as well as schools with less severe default problems, already must take a series of measures including, for example, default management plans and pro rata refunds designed to improve educational quality and prevent defaults. These regulations also require that schools offering a vocational training program calculate and release their program completion and job placement rates.

These changes go a long way, and they are working; but they are not enough. We need more statutory authority.

Well over a year ago, I submitted to Congress the second component of the Student Loan Default Reduction Initiative, the "Student Loan Default Reduction Amendments of 1989." This bill would improve entrance standards for students admitted under the "ability to benefit" provision, prohibit commissioned recruiters, require lenders to offer graduated repayment options to borrowers, allow guarantee agencies to garnish defaulters' wages, require lender credit checks of potential student borrowers, expand our pro rata refund policies, grant emergency action authority, and prohibit "accreditation shopping" for schools that lose their eligibility.

These proposals were well-conceived, and few people doubt their necessity. But to date, only the last three of these eight provisions have been enacted into law by the Congress, with the pro rata refund provision only in effect for this fiscal year.

Senator NUNN. Mr. Secretary, could you explain a little bit about what the "ability to benefit" change is, and also the pro rata payment?

Secretary CAVAZOS. Yes, sir. The "ability to benefit" provision was put into the law some years ago. Under current law institutions can give an examination to determine ability to benefit to those students who have some minimal education.

Senator NUNN. Or less than a GED or a high school education.

Secretary CAVAZOS. Yes, less than a high school education. What happens is the schools give the exam, and depending on the testing mechanism everyone can be found to have the ability to benefit and consequently be found eligible.

Now, we have requested at least three times a change in that. In fact, on this last proposal, we requested independent third party testing, independent of the schools, so that we really can get a more objective measurement of "ability to benefit."

I think that that is an important step, and it is one that I really hope, Mr. Chairman, we can get through this year. It would help an awful lot.

Senator **Nunn**. Well, that needs changing; I don't think there is any doubt about it. Now, your predecessor, Mr. Bennett, wanted to eliminate the "ability to benefit" altogether and require only high school graduates or GED, as I understand it, to be eligible. You are not endorsing that position?

Secretary **Cavazos**. No, I'm not endorsing that. What I am saying is I would like to take the "ability to benefit" out of the control of the schools. They are administering it, and sure, everybody is going to have that ability to benefit.

Senator **Nunn**. That's like sending somebody to a lawyer and asking if the lawyer can help them, right? [Laughter.]

Secretary **Cavazos**. What shall I say, Counselor?

Mr. **Stringer**. Say "yes".

Secretary **Cavazos**. OK. [Laughter.]

Senator **Nunn**. If the Federal Government pays the bill—can the lawyer help me.

Secretary **Cavazos**. And basically, to me, this is a critical change that we need to have in place.

The pro rata refund is also very important. We initiated that——

Senator **Nunn**. Let me ask you this on that question because this is an important area. On "ability to benefit," basically, the law now is that the schools that are getting the money from the Federal Government, that are profitmaking schools, are also the ones that are administering the tests to determine if the student meets the criteria which is the ability to benefit—which is a very, very broad, subjective kind of criteria.

Secretary **Cavazos**. Yes, sir. And we have requested that from the Congress, I don't know—does anybody know how many times this has been requested over the past few years—and we have been unable to get it changed.

Senator **Nunn**. In the past, Mr. Secretary, your predecessor was not suggesting the same change. It is my understanding he had advocated eliminating that criterion altogether, meaning that you would not have been eligible for these kinds of skill training courses with Federal help unless you had a high school diploma or its equivalent; is that right? Is there a difference between your position and Mr. Bennett's position?

Secretary **Cavazos**. Quite a bit of difference, yes, sir.

Senator **Nunn**. Tell us what is wrong with the position he was advocating, in your view.

Secretary **Cavazos**. Well, I think here again you do have to have some demonstration of the "ability to benefit." Don't misunderstand me. I am not against the "ability to benefit" demonstration, and GEDs and high school diplomas are going to vary. I'd like to see somebody out there saying, yes, you can benefit from this, but the testing must be done independently.

So basically, that has been my——

Senator **Nunn**. But you are not ready to move to a standard of just high school diploma.

Secretary **Cavazos**. No, sir, absolutely not.

Senator **Nunn**. That would cut out too many people.

Secretary **Cavazos**. I am afraid it would, I am afraid it would.

Senator NUNN. OK. You want an objective group that doesn't have a stake in getting the Federal loan and putting it in their pocket and making money off of it.

Secretary CAVAZOS. Exactly.

Senator NUNN. You want somebody else to give the test.

Secretary CAVAZOS. Yes. In fact, I've got to admit a lot of things have given me gray hair since I came on this job, but I was frankly just appalled that that one was in there because as a former teacher and educator, it is just not the way that one should help. Testing of this kind or any kind is really developed as a learning tool and gives that opportunity. So therefore, we feel that that is an important aspect of what we need to do.

The pro rata refund aspect of this thing is something that we feel is important because again, when students come into these proprietary schools, they might stay only a week, or 3 weeks. If they are not qualified, they drop out of school, and they owe the whole debt. What we are proposing is to require refunds on a pro rata basis, and that will make a lot of difference, Mr. Chairman.

Senator NUNN. Why not just pay it out on a pro rata basis? Why not have some incremental payments instead of giving a proprietary school—maybe the other schools are somewhat different, and maybe there has to be a distinction here—but why is it that you give them the whole lump sum up front?

The Veterans' Administration doesn't do that. I understand the Veterans' Administration programs, they basically pay as they go.

Secretary CAVAZOS. I really don't think I could answer why we do it that way other than that is the way it is done. I certainly would not object to looking at that possibility—and I am sure that will cause a lot of heartburn out there in the hinterlands.

Senator NUNN. Well, it may, but the taxpayers are getting a lot of heartburn now. And it seems to me on the proprietary schools—and maybe they should be distinguished from others where they've got good track records—but so many of them are having problems, and it seems to me there is a real case to be made to pay them less than the total, at least; rather than having to try to get the money back, it would be better never to give it in the first place until a certain level of accomplishment had taken place.

Secretary CAVAZOS. Actually, in our Student Loan Default Reduction Amendment, it does apply; the pro rata refund portion applies only to those schools with high default rates. But it still comes up lump sum, so therefore, it is certainly one that we could be looking at as a possibility.

Senator NUNN. Well, I hope you will take a look at that.

Secretary CAVAZOS. All right, sir.

Senator NUNN. Why don't you go ahead? I interrupted you, but I wanted to cover those two points.

Secretary CAVAZOS. That's all right. We are here to try to straighten this whole thing out.

As part of the original budget agreement reached between the President and congressional negotiators, the authorizing committees will likely be instructed to achieve a $2 billion saving over 5 years in the Guaranteed Student Loan Programs. We have suggested a set of proposals to Congress that will not only meet these budgetary levels, but implement key default reduction measures and provide important new authority for the Department of Education

These include: strengthening departmental authority to oversee guarantee agencies; delaying disbursement of loans for 30 days; barring commissions for recruiters; requiring credit checks for borrowers over age 21—which is an obvious kind of thing that one would be doing—requiring graduated repayment options; authorizing guarantee agencies and Department of Education wage garnishment; requiring pro rata refunds; amending the bankruptcy law so that accreditation and State licensure are not protected as "property;" extending the prohibition against supplemental loans for students at high-default schools; eliminating Title IV eligibility with opportunity for limited appeals, for schools with default rates over 40 percent for the first year, 30 percent for the second year, and 25 percent for future years, and restricting eligibility for correspondence schools.

Again, I urge quick congressional action to provide the Department with the needed tools for eliminating program abuses and reducing defaults.

There are several other administrative and regulatory actions we have taken to reduce loan defaults and stem the tide of program abuses.

The Department manages the defaulted student loan collection process and has achieved impressive results. In fiscal year 1990, $291 million was collected through the IRS offset; $100 million was collected by the Department or private sector collection contractors; and $349 million was collected by guarantee agencies and forwarded to the Department.

The Department is taking numerous administrative actions to further improve the efficiency of these collections.

To improve our determinations of compliance with student aid regulations, we have dramatically increased the number of onsite reviews of postsecondary institutions. Let me point out how. In fiscal year 1987, we did 372; in fiscal year 1990, we have completed over 1,200 of those reviews. We have also increased the number of lender and guarantee agency reviews from 232 in fiscal year 1987 to 554 in 1990.

The Department is assigning program review teams to undertake comprehensive and regular reviews of all guarantee agencies. The first cycle of reviews covers 14 of the 54 guarantee agencies. The Department has also engaged the services of a financial management firm to provide support to the program review teams in analyzing the financial condition of each agency. Following the first cycle of reviews, the Department will complete successive cycles of reviews for the remaining guarantee agencies. We plan to monitor the guarantee agencies closely and to continue the reviews on a routine periodic basis.

The Inspector General's Office has also increased its attention to the student aid program, displaying an impressive record of identifying abuses in the student aid programs and recommending improvements. In response to our IG's findings, the Department has implemented many changes in the student aid system.

For example, we have strengthened the financial certification requirements for participating schools and improved aspects of our certification procedures. We are now proposing regulations to eliminate a loophole through which institutions were able to get more aid than the actual length of their courses warranted, and we are developing regulations to prevent accreditation from in effect being "bought" through the affiliation with branch campuses.

It is becoming increasingly clear that many accrediting agencies are not doing the job we have entrusted to them. Before a school may participate in the Federal student aid programs, it must be accredited by an agency recognized by the Secretary. The National Advisory Committee on Accreditation and Institutional Eligibility is responsible for advising me about recognizing the agencies that petition for recognition. The Advisory Committee needs to improve greatly the quality of its advice. I have directed the National Advisory Committee to target those agencies that accredit schools with excessive default rates.

For example, on September 10, 1990, I released the names of 89 schools which accounted for more than 30 percent of all the defaulted loans in the 1988 cohort—just a handful of schools. These 89 schools, some of which have already closed, represent less than 1 percent of the Nation's 10,000 postsecondary institutions; yet they account for $365 million of $1.2 billion that went into default amongst the 1988 cohort.

Even more astonishing, 84 of these 89 schools were accredited by only seven of the Nation's 96 recognized accrediting agencies.

Accrediting agencies must focus on educational effectiveness and must see to it that schools with high default rates are held accountable. We will continue to emphasize the examination of educational outcomes and institutional accountability.

Less than 3 weeks ago, the Department's emergency action regulations went into effect. These regulations make it possible for the Department to immediately suspend schools that are violating the law, hurting needy students, and costing the taxpayers millions. Last Thursday, I announced the immediate suspension of student financial aid to 14 for-profit trade schools, based on this new authority, and I promise you that we plan to continue aggressive monitoring of all schools, and I will not hesitate to use this authority in the future.

I am gratified by the successful resolution of the problems surrounding one of the largest guarantee agencies, the Higher Education Assistance Foundation, or HEAF. We were concerned that a HEAF collapse could have reduced student access to loans and limited lender participation in the student loan programs.

On September 28, I announced an agreement in principle with the Student Loan Marketing Association, or Sallie Mae, to manage HEAF's portfolio. This agreement will stabilize the guaranteed student loan program, and will assure students and their families continued access to loans, avoid a recurrence of the problems causing HEAF's financial difficulty, and keep costs to the taxpayer at a minimum.

Finally, the upcoming reauthorization of the Higher Education Act will give us an opportunity to make major changes in the student aid system so that it works to achieve our national education goals, while protecting the interest of the taxpayers, who expect us to run our programs fairly and efficiently. In developing our reauthorization proposals we are considering the need for restructuring the system.

We will have the chance to accomplish more than marginal system repairs.The Administration's proposal will be transmitted to the Congress early in 1991.

The Department's reauthorization proposal will be based on the four themes of President Bush's educational policy: rewarding excellence and success in education by providing Federal incentives for educational achievement; targeting Federal dollars to help those most in need; promoting choice for individuals and flexibility in existing program delivery; and providing greater accountability.

One of the most pressing issues in higher education and a major focus for our reauthorization is to improve the quality of postsecondary education. We believe that focusing more on performance, strengthening standards for State licensure, and improving the accreditation, eligibility and certification process will greatly improve quality amongst our postsecondary institutions. This has been and will continue to be a major emphasis of the Department's activity.

Mr. Chairman and members of the Subcommittee, thank you for this opportunity to present my remarks and to bring these important issues to the attention of the Nation. Your Subcommittee is fulfilling its mandate to investigate poorly-performing programs and to propose solutions to the problems it finds. Working together, we can assure a national student aid policy that truly serves all the Nation's postsecondary students and protects taxpayers' dollars.

I hope that you will support our current legislative proposals in this area. We believe that these will help us improve our ability to manage the programs and monitor the activities of all program participants.

I also hope that you will consider favorably our forthcoming reauthorization proposals which will focus on improving the quality of postsecondary education.

We would be pleased to answer your questions, Mr. Chairman and members of the Subcommittee.

Senator NUNN. Thank you, Mr. Secretary.

Let me call on Senator Roth now for any comments he'd like to make, and then we'll go to questions.

OPENING STATEMENT OF SENATOR ROTH

Senator ROTH. Thank you, Mr. Chairman.

I apologize for being late. We do have the budget before the Congress and unfortunately I got involved in a meeting considering that.

I do once again want to commend you and your staff for what I think are extremely valuable hearings. It is regrettable, but we have heard repeatedly that there are numerous weaknesses in the student loan program. We have seen how "fast buck" school operators easily gain access to the system through questionable accreditation practices. We have heard about lending institutions who blatantly violate student loan lending policies, and we have heard about weaknesses in supervision and oversight by the Department of Education.

We also have heard about how Congress has added to the student loan "feeding frenzy" by creating loopholes in the law. For example, we heard that a special provision was inserted in the 1986 reauthorization of the Higher Education Act, permitting FITCO, the First Independent Trust Company, to continue in business and to far exceed the 50 percent limit on student loans applied to other lending institutions.

Well, FITCO finally crashed and took a good portion of the secondary loan market with it.

In my view, it is relatively easy to see where the big losses in the student loan program are occurring. According to statistics released by the Department of Education for schools with calculated default rates, more than one out of four proprietary schools participating in the student loan program have a default rate of over 30 percent. The Culinary School of Washington, D.C. at one point operated with a default rate of 70 percent.

I recognize that default rates are not the only measure of a school's success. As I have stated before, I commend the many proprietary schools that provide good education and decent training. But, Mr. Chairman, we can't ignore the facts. Most of the problems we have heard about in this series of hearings can be attributed to problems with proprietary schools. Lenders like the First Independent Trust Company, who aggressively make loans to disreputable trade schools, eventually paid the price for their conduct. Similarly, we heard testimony that some guarantee agencies got into trouble, in part, because of too many high-risk trade school loans in their portfolios. It seems clear to me that the student loan program faces a potentially disastrous chain reaction of events which can be traced to the dishonest practice of some proprietary schools.

I fear that unless major changes are made, the problems identified in these hearings could bring the entire student loan system to its knees—something none of us want.

We need to ask some tough questions about this program. Has Congress demanded that the Department of Education achieve mutually exclusive goals by demanding, on the one hand, a reduction in defaults, while on the other hand demanding that virtually all students have accessibility to all schools? Has Congress been responsive to requests that the Department has made for changes to reduce losses in the student loan program? And finally, Mr. Chairman, is Congress prepared to make the tough choices necessary to eliminate the bad actors from the program?

The late, and perhaps not much lamented, budget summit agreement projected $2 billion in reduced student loan defaults over the next 5 years. Whatever happens to that budget, we can and do need to achieve these savings. But in my judgment we will not do so without major changes in the student loan program.

Again, I want to commend you, Mr. Chairman, and your staff for your outstanding work and express my appreciation to the Secretary for being here today.

Senator **Nunn**. Thank you, Senator Roth.

We'll rotate back and forth on questions. I'm going to ask a few, and if you want to join in at any point, as long as there are just two of us here, we'll go that way, and then we'll switch back and forth. I believe that we'll probably have other Senators joining us; I think Senator Kennedy has indicated he was going to be here and is very interested in this legislation that you are talking about and perhaps some of the recommendations we may make.

Mr. Secretary, we certainly welcome your efforts at reform, and we welcome your recognition of the significance of these problems; I think you have made that clear this morning.

I don't want to get too far back into history, but I think we have to go backward somewhat to see where we are going in the future. In March 1987, the Inspector General made several recommendations to improve the quality and accuracy of the guarantee agency database. [See Exhibit No. 1.] It is my understanding that not a single one of these have yet been enacted.

In August 1988, the Inspector General found that correspondence schools may be overcharging students for registration fees and equipment. The problem was traced to inappropriate refund policy, but it is my understanding also the Department of Education has not acted on that.

In August 1988, the Inspector General recommended program reviews at student financial aid services. We also learned what happened at United Education and Software, which had not received an adequate program review on its $1 billion loan portfolio. But the Department has not acted on that IG recommendation, either.

And in 1989, the IG completed its sixth Management Improvement Report, containing 19 recommendations for improvement in the student aid program. The Department has not completed action on any of these recommendations as of my information.

Now, I welcome your legislative initiatives, and I think I would probably agree with virtually every one of them—there may be a couple I have questions on—but we really ought to take corrective action here in Congress. But there is tremendous authority that exists in the Department of Education that has not been utilized independent of any kind of statutory changes. And we have numerous recommendations from IG and others about things that specifically should be done, and these recommendations go back several years.

Can you tell us why those efforts have not been done? Has the Department gone through each one of these and decided some of them wouldn't work, or have you basically ignored the recommendations of the IG—"IG" standing for "Inspector General".

Mr. **HAINES**. I would be happy to respond to that, Mr. Chairman. I think all of the Inspector General reports that you are referring to, we have responded to in the sense that we have gotten back to the IG, told them how we were reacting to their particular recommendations, and in virtually all instances, with some exceptions, we have agreed to go forward with their recommendations.

Senator **NUNN**. But have you gone forward? There is a difference——

Mr. **HAINES**. We have gone forward in a very large number of areas. Let me——

Senator **NUNN**. Could you trace each one of those for us, for the record, each one of these IG recommendations, and tell us whether it has been rejected and the policy reasons for the rejection? I'm not saying every one of them is sound; they may not make sense. But I'd like to see what your track record is on each one of these

IG recommendations and whether any of them or which ones have been implemented.

Mr. **Haines**. Okay. Could we provide that in written form for the record? We certainly will do that because we have those responses at hand, and we should be able to respond to you very quickly. [See Exhibit No. 2.]

Senator **Nunn**. For the record, yes.

Mr. **Haines**. Let me respond in particular to your mention of the institutional data system that the IG did a report on—certainly with our blessing—and we encouraged the IG to look into this area and give us some recommendations as to how that system might be improved. They did, and we did indeed respond. We have had 10 temporaries working over the period from roughly the middle of May to the end of September getting that institutional data set up to snuff by going through the hard copy files and updating all of the data on the institutional data system.

That, Mr. Chairman, is an awesome system. We are very, very close to having one of the best databases that you can imagine for tracking all of these programs. It has 6 major subsystems currently, one for eligibility, one for certification, another for default management—and this is the first time that that has happened——

Senator **Nunn**. When did you embark on that program of changing the data system?

Mr. **Haines**. We have been working on that data system even before the IG looked into it. It has really been a question of resources. We started that data system back in 1985, and it has been kind of catch-as-catch-can with respect to getting the resources that we have really needed to do a couple of things—both to develop the system and the contract support that we needed to do that, and also the people to put the hard copy data on the database.

The latter part of that, we really didn't accomplish until this summer. I know one of the comments in some of the materials that I have looked at is that the data system might only be 50 percent correct. We believe we are close to 90 percent in terms of the reliability of the data in that system at this point, and certainly by the end of the fiscal year, as our regular staff continues to review and finalize that data input, we will be in very, very good shape. So I am very proud of that system——

Senator **Nunn**. But Mr. Haines, let me——

Mr. **Haines** [continuing]. And very proud of the reaction that we have had to that MIR.

Senator **Nunn**. Well, I am delighted that you are making those improvements, and I'm sure that is going to help.

I have here a report dated October 1, 1990 by the U.S. Department of Education, Office of Inspector General, and it says here: "guarantee agency record dump data is not complete or accurate". That critique report was written in March of 1987, Semiannual Report Number 14, and the status of recommendations per management is now "open," meaning it has not been completed.

Now, can we expect 3½ years to do something like this from the time the IG issues the report until we are still struggling to get it completed? Is 3½ years reasonable?

Mr. **Haines**. I don't really think so, and I think what you are referring to is the tape dump data, which is a student data set which we use to develop default rates by institutions, and then it is the default rates by institutions that get put on the institutional data set. I think there are still some problems in the tape dump and the reporting of that data by the guarantee agencies. We are continuing to work on that problem.

Senator **Nunn**. I guess the question that people out there who are paying the taxes would ask, and the students who are the victims in this case is why does it take so long for the Department of Education to do anything. What is it over there—is it the Office of Management and Budget that won't give you the people, won't let you train people, won't give you enough money? It is the Congress that is turning down the requests from the Administration on the number of people to administer this program? What is it that is doing this?

Mr. **Haines**. I think in somewhat broad terms that one of the things we find in the Department of Education and elsewhere is that when you are trying to develop data sets in order to track your management and your management improvements, that is one of the last things to get attention until a crisis is created, either by a committee such as this or by the IG or whatnot. So I think that——

Senator **Nunn**. I don't think we created the crisis. We didn't create the crisis; we discovered it.

Mr. **Haines**. No, no, you didn't create the crisis, but you gave it some visibility——

Senator **Nunn**. Right.

Mr. **Haines** [continuing]. And that visibility indeed moves people all up and down the line to deliver the kinds of resources that are needed.

Senator **Nunn**. But my point is the parent committee here, the Governmental Affairs Committee, set up these IGs in virtually every Department. They are built basically to issue reports, and there is supposed to be internal management. Now, Congress has an oversight role, and that is one of the things that I think needs most strengthening over here in the Congress, and I have said that for years; we have a long way to go. But the only oversight that is available should not be in Congress. The basic oversight starts within the Department itself and the IG. So you really should not have to have a congressional subcommittee looking into this in order to take a look at your own IG reports and say, "this is an alarm bell, and let's do something about it."

Are you saying that it takes a basic kind of real thrust of publicity, adverse publicity, to get the Department moving?

Secretary **Cavazos**. Let me try to answer that, Mr. Chairman, if I may.

One of the other things that I started—it has been a year now—has been the resolution of all audits; where we find any problem with those audits, they come forth. I've got an audit committee now that we have established in the Department, chaired by the Under Secretary. They meet weekly and look at all of the exceptions that we have on our audits, and also they report to me in terms of tracking and what is being done and what is being done to resolve it. So that perhaps in the past, that was the precipitating factor for looking at these things, once they got a lot of heat, and the system just responded.

But I think that the system we now have in place gives us the management tools to do the kinds of things that you are talking about. I really believe that that might be one of the most significant things that I have done since I have been in the Department is to try to track the audits. I have been very, very careful to make sure that that IG is independent and working the way that area should be doing. I count a lot on it, but for the first time—it has been about a year now—we have managed to move all of these things, and they are meeting all the time and resolving those. When there is a long delay in resolving one, they hit my desk. So hopefully, that won't happen again. But you are right, that is what tends to get the attention quite often.

Mr. **Haines**. Let me say, Mr. Chairman, I think that under this Secretary we have made more movement in the direction of developing a good management data system than at any time that I can remember in the last 15 years that I have been in the Department.

Senator **Nunn**. Well, I'm glad to hear that.

Last month, the General Accounting Office testified they have been unable to audit the Guaranteed Student Loan Insurance Fund because of "the poor condition of the financial records" at the Department. So we've got the General Accounting Office basically saying they can't even audit the books because they are not properly maintained.

We also had the Consumer Bankers Association testify that the Department is operating on 1970's computer technology. Maybe that is what you are talking about updating.

What kind of condition are your financial records in if the General Accounting Office can't even audit them?

Mr. **Haines**. I am not really prepared to speak to that particular side of the Department; it is part of OM and not part of my institutional data responsibilities.

Mr. **Canellos**. Let me try to answer that, Senator.

It has been recognized—and I have only been in Student Financial Assistance for 2 months, so my personal knowledge is limited, but I have tried to make a study of what the problems are and am trying to contribute to some of the solutions.

One of the first problems that is apparent, as you have recognized, is that the computer systems are antiquated, and it takes a supreme effort to try to bring them up-to-speed.

In the long term, there is a plan to create a new computer system, the National Student Loan Data System, which was authorized and which is now presently being planned and will be implemented—I believe the year is 1993.

There is always a question how much effort do you expend to patch up a system that most people would say can't be patched in the view of trying to hold on until the new system comes into being.

I think as far as I have been able to learn, we have been doing as best we can, putting extra people into the old system, but our efforts are aimed at the new system, which hopefully will solve many of the computer and information problems that have occurred in the past.

Senator **Nunn**. Wasn't that new system authorized by the Congress in 1986?

Mr. **Canellos**. Yes, sir, it was.

Senator **Nunn**. And it is going to take 7 years to get it in place?

Mr. **Canellos**. Senator, I can't answer that.

Senator **Nunn**. You said it would be in operation in 1993.

Mr. **Canellos**. That is my understanding, yes.

Senator **Nunn**. Is that normal, 7 years?

[No response.]

Senator **Nunn**. Senator Kennedy, we are delighted to have you this morning. We appreciate you coming. We are talking about this series of problems, and the Secretary has testified, and we are really just getting into questions, but we are delighted to have you. You and I have talked about these hearings as we have proceeded, and I know that your Committee is very interested in this and is taking a look at a lot of this legislatively right now.

So we are delighted and honored to have you here.

Senator **Kennedy**. Thank you, Mr. Chairman.

Mr. **Haines**. If I could speak to that last issue——

Senator **Nunn**. Yes. I'm just asking whether it takes 7 years—now, I'm not an expert in computers or data, and I don't pretend to be, but that seems like a very long time to correct a system.

Secretary **Cavazos**. Let me try to clarify. The Student Loan Data System was authorized in 1986, but the restrictions Congress imposed on its use meant it could not be used to track defaulted loans. And it wasn't until last year that the restrictions were removed so that we could use that data base to track defaults.

So it really didn't do us any good in the interim.

Senator **Nunn**. You mean Congress had restrictions on what you could use this——

Secretary **Cavazos**. They had restrictions on what we could use it for. So now we've gotten that out of it——

Senator **Nunn**. Well, it seems to me when you've got the General Accounting Office testifying they can't even audit the Guaranteed Student Loan Program because of "the poor condition of the financial records at the Department," that somebody ought to be on the warpath over there, Mr. Secretary.

Secretary **Cavazos**. Well, I think you will see, Senator, from the number of changes that I've made here in the last year that we are on the warpath.

Senator **Nunn**. Let me yield to Senator Roth for questions, and then I'll come back.

Senator **Roth**. Mr. Chairman, I have great sympathy for what you are saying. I think the problems with this program seem to be fairly typical of the Government's ability to manage. I might point out that Congress cannot get a budget enacted.

I think there are some very serious problems with the inability of either the Executive Branch or Congress to manage or create policies that are constructive and self-supporting.

For example, some people feel that the student loan program has conflicting goals. On the one hand, we want to reduce the number of defaults because the defaults are giving the whole program a bad name. While on the other hand, we are eager, as we should be, to provide accessibility to all potential students, not only to graduates of high school or to those attending 2- and 4-year institutions. We strive to make training available to the poor and to those who have not attended high school.

How do we reconcile these different goals? Should they all be part of the same program, or is that part of the problem?

It has become clear through these hearings that much of the problem is concentrated in a few proprietary schools—some of them are doing an excellent job. Can we amend these programs so that they will work effectively, or do we need to look at the entire student loan system and try to create different programs for different needs?

So I go back to my question, Mr. Secretary. Is part of the problem that we are setting conflicting goals for you?

Secretary CAVAZOS. Thank you, Senator.

Let me respond to it in this manner. I do not believe that the solution is going to be found on a patchwork sort of basis. I really believe that the opportunity I talked about in my written testimony of reauthorization is really the key to what we are going to be doing.

The Higher Education Act has been in place for 25 years and in looking at it, it is clear that it grew by accretion. I understand that the Department of Education previously has not always submitted reauthorization proposals in a timely fashion. And I found out, of course, in the early months of my administration that we were coming up for reauthorization.

After 35 years in higher education, you know good and well I am not going to pass up an opportunity to do a higher education reauthorization because I certainly felt there were many areas where there could be great improvement if we work together with the Congress in preparing the bill.

I appointed committees within the Department and I said, "Forget the old bill. Get yourself a clean sheet of paper, and start all over again and address these fundamental issues of the student loan defaults and reward quality education; emphasize how we can improve the whole structure."

So we will have a unique opportunity by the first of next year before the Congress to look at some of these issues.

Now, your statement also suggests that there are some people who say, well, the way to fix this thing is to get rid of the trade schools, or don't put them into the guaranteed student loan program, or at least, in the portion we have them in.

First of all, I oppose that. I oppose removing them from that for a variety of reasons, and I will explain.

First of all, there are a lot of very, very good proprietary schools out there. And to say, OK, we know that the defaults are concentrated in a small number of schools over here, so let's throw out all the rest of them that are doing a good job and providing the access, Senator Roth, that you talked about and the opportunity for youngsters, I think would be a serious mistake.

I know that some of my colleagues in higher education do not go along with that viewpoint, and they say, well, let's get them out of here so they are not impacting this program.

Secondly, it is very, very clear that these proprietary schools are serving a different kind of student, and we have to make that access available to those students. What I am concerned about is if you take them out of here and you move them somewhere else in the Department of Education, presumably, think of the massive paper work that we have to start all over again, building an entire new system.

But what is the difference? If there is going to be default, then let's at least keep them together so we can work on the default issue. But to separate it and still have to deal with default on both sides would not be useful. Now, that's not to say that all the default occurs at the proprietary schools. There are some higher education institutions that have pretty substantial defaults as well, and we are working with them. There are some proprietary schools that have very low defaults.

So the issue to me, Senator, is one of strengthening our ability to get the job done, rather than saying the easy way to fix this is to get rid of them.

Senator ROTH. Why does it take so long to take action against the bad apples? It only takes a few bad apples to give the whole program a bad reputation.

Secretary CAVAZOS. Here again, we are restricted in the system as to how fast we can really take action.

I am going to ask General Counsel to talk about that.

Mr. STRINGER. Senator, recently the Department acquired authority to take emergency action, and that has helped a great deal to cut through the very prolonged process of terminating the bad actors and cutting off——

Senator ROTH. Who set up the procedures?

Mr. STRINGER. Well, it is the due process procedure that requires a hearing and extensive testimony-taking, evidence production, and——

Senator ROTH. Is this written into the law?

Mr. STRINGER. Yes. The administrative law procedure for terminating a school requires a very extensive hearing process, and we now have the authority as of the latter part of September to cut that off and to take emergency action, which the Secretary announced last week he was taking with respect to 14 schools.

So that problem has pretty much been set aside, and we have the tools and equipment at this point to move very aggressively on schools that should be taken out of the system.

Senator ROTH. I have other questions, but I will defer to you, Mr. Chairman.

Senator NUNN. Thank you, Senator Roth.

Let me ask a couple more questions, and then I'm going to give Senator Kennedy a chance to make a statement or ask a question, since he has played such a key role in this, and we appreciate him coming to these hearings.

Mr. Secretary, following the revelation that the Higher Education Assistance Foundation, HEAF, was experiencing grave financial problems and was in danger of becoming insolvent, you directed the Department to review several other guarantee agencies. What did you find in the review of other guarantee agencies? Was the HEAF example one of many, or was it an exception?

Secretary CAVAZOS. Just by the fact of the enormity of the program itself, it became an exception. But I would simply say that we looked at the others because of the same kind of concern that that didn't happen in the future; there were 14 of them.

Do you want to talk about that, Mr. Canellos?

Mr. Canellos. I think I can address that, Senator. As a result of the revelations of HEAF, the Secretary directed and we implemented a plan to examine I think it was 15 guarantee agencies. The basic purpose was to see and to check the financial condition to see if they matched the HEAF scenario and also at the same time to look at their enforcement practices and the rest of the guarantee agency checklists that we have. That was an initial plan.

In addition to that, we have a plan now to examine all the guarantee agencies within the next 6 months, and to that end, I think we are planning to visit five of them in the next couple of weeks as soon as the travel budget is loosened up, and then periodically every 2 weeks, three or four at a time.

I can say categorically that there are no guarantee agencies that are in the same condition that HEAF was at the time.

We still have, of course, preliminary information. We have the Kidder-Peabody people doing financial analysis to see the real indepth condition of these agencies, and we do not have final word on any of them, but certainly nothing that would indicate a HEAF-like scenario on any of the agencies that we visited.

Senator Nunn. Are you familiar with the Nebraska II guarantee agency?

Mr. Canellos. Yes, I am, Senator.

Senator Nunn. What percentage of Nebraska II's portfolio is made up of proprietary school loan guarantees?

Mr. Canellos. I don't know the exact figure. It is substantial, but it is decreasing is the last word I have.

Senator Nunn. I have been told it is about 90 percent.

Mr. Canellos. Ninety percent and going down—of course, it can't go any higher, obviously, but it is headed down.

Senator Nunn. What is heading down, Nebraska II or the default rate? [Laughter.]

Mr. Canellos. Well, the percentage of proprietary schools in their portfolio is going down.

Senator Nunn. What is Nebraska II's default rate?

Mr. Canellos. They are under the 5-year grace period. They are fairly new, and for the first 5 years, they don't fall under a trigger mechanisms which will reduce their repayments. But that will expend I think next year, and they will fall under the regular criteria. If it is a 5 percent default rate, they only get 90 percent reimbursement; 9 percent, they get 80 percent reimbursement. But they are not in that window yet.

Now, they have a management plan——

Senator Nunn. Do you know what their default rate is now?

Mr. Canellos. We do not calculate that default rate at this time, since they are not under the trigger mechanism.

Senator Nunn. Wait a minute, now. If they are not under the trigger mechanism—and I understand the grace period here—but you don't even keep up with the default rate if they are not under the trigger?

Mr. **Canellos**. Let me check that, Senator, but we certainly don't use it to calculate reimbursement. But obviously, somewhere in the Department, we know what their default rate is.

Senator **Nunn**. I would hope.

Mr. **Canellos**. As I was saying, they have a management plan, which I certainly won't get into detail about, but it indicates their management proposal as to how they are going to reverse that trend and get out of their current situation. And that hasn't been analyzed completely by the management folks, so I can't say anything more than that.

Senator **Nunn**. I believe there may be a message there on the default rate.

Mr. **Canellos** [Conferring with staff]. Apparently in 1989, their default rate was 2.6 percent.

Senator **Nunn**. That's the last you have?

Mr. **Canellos**. They just started I think it was 3½ years ago.

Senator **Nunn**. So we really don't know where they are going now because they haven't had time to have a mature default rate.

Mr. **Canellos**. That's right, Senator. Until their students have graduated and become part of the repayment schedule, we really don't know.

Senator **Nunn**. You are obviously concerned about it with this high a percentage of loans to proprietary schools, are you not?

Mr. **Canellos**. I think we are concerned with any agency that has a high proprietary mix of loans, but I can't say concern beyond that is apparent.

Senator **Nunn**. Mr. Secretary, your program staff has reviewed HEAF operations, is that correct?

Secretary **Cavazos**. Yes, sir.

Senator **Nunn**. Did you find fraud at HEAF as opposed to simply mismanagement and waste?

Secretary **Cavazos**. I am not aware of any fraud that we found there. It was mismanagement. The IG took a hard look at that as well as our people took a look at it, and they found nothing. Perhaps, Ed, you have something to add to that.

Mr. **Stringer**. Senator, when the HEAF crisis broke in late June, we sent out a team from the Department immediately. They spent 10 days or so in St. Paul. Following that, the IG's team went out, and between the two investigations, there has been no indication of fraud or abuse of the system.

It has been purely a case, as we can see, of mismanagement.

Senator **Nunn**. Would you tell us, Mr. Secretary, a little bit about the HEAF solution, the Sallie Mae solution to the HEAF problems?

Secretary **Cavazos**. Yes, sir. It has been, of course, our goal to maintain the integrity of the entire student loan system. You can recognize it put tremendous pressure on our Department to resolve this issue because first of all, this was in September, and school was coming up, and a variety of other problems were in front of us.

So we went to work in trying to find the best solution to straighten out the HEAF problem. I am going to ask General Counsel to go into the details of how we resolved that and what our recommendations were.

Senator **Nunn**. If you could just give us the concept of the solution.

Mr. **Stringer**. Mr. Chairman, the concept of the solution is a workout. Sallie Mae has contracted with the Department to provide a service to HEAF, and Sallie Mae will in turn contract with HEAF, to take the existing approximately $9 billion loan guarantee portfolio and to distribute it out among the various guarantee agencies out across the country. The portfolio is to be distributed by contract to guarantee agencies with less than 5 percent default rate, so that it will not affect their default rate, it won't take them up or down below the 90 percent level.

This is to be done within 3 years, and if it isn't done within 3 years, then Sallie Mae will continue to operate HEAF at its expense.

It will be supervised by a board of directors of six, three to be appointed by Sallie Mae and three to be appointed by the Department.

Sallie Mae will be compensated in three different segments—$3 million a year for the 3-year period, representing their costs; an incentive on the basis of the speed with which they get the guarantees distributed out among the various guarantee agencies; and finally, an incentive based upon the excess of cash they turn over to the Department at the end of 3 years over and above $150 million.

The enterprise is to be financed by the collections. HEAF will retain the defaulted loans, and the payments on the defaulted loans will be used to finance HEAF during this 3-year period.

Senator **Nunn**. Does HEAF go out of business as far as doing any new guaranteeing?

Mr. **Stringer**. Exactly; as of the end of this month at the latest.

Senator **Nunn**. How much capitalization do you require for a guarantee agency to go into business?

Mr. **Stringer**. Well, there isn't really any capitalization required, Senator. We review the proposal for a guarantee agent, and our oversight authority basically goes to can they perform the program as required. There is no basic minimum capital requirement.

Senator **Nunn**. Well, maybe I don't understand the concept of this, but you've got this agency out there basically acting as the middleman for the Federal Government, guaranteeing, and then the Federal Government is backing that up, but as the default rate goes up, the Federal guarantee goes down somewhat, so there is an incentive for them not to go into a high default rate. But if there is no capitalization, what good is that guarantee to the Federal Government?

Mr. **Stringer**. Well, it is the middleman that administers this program on behalf of the Federal Government. There are certain quality performance requirements built into this related to the default rate, so if a guarantee agent takes bad paper, does a poor job in its guarantee function, and has a default rate, obviously it is going to be penalized by that.

Senator **Nunn**. But if it has no capitalization, then there is no penalty that can be obtained because there is no money there.

Mr. **Stringer**. Well, the money obviously comes from the fees that the guarantee agency receives in its operations, as well as any collections it makes.

Senator **Nunn**. OK. Now, HEAF got in trouble because they lost part of their guarantee; they went from 100 percent down to 90, and in many cases, 80, and therefore they got in trouble—right?

Mr. **Stringer**. That in addition to their marketing very aggressively in the proprietary markets and waiving their guarantee fees up front. That was a part of the problem.

Senator **Nunn**. So they lost fees on the income side, and they lost reimbursement from the Federal Government on the default side.

Mr. **Stringer**. Right.

Senator **Nunn**. OK. Now, what happens to those loans that you are basically removing from HEAF and putting in other guarantee agencies? Is the Federal Government going to reimburse at the 80 percent level which HEAF would have gotten because of the high default rate, or is the Federal Government going to come in with these new guarantees, the new people that are getting involved, Sallie Mae and others, and go back to the 100 percent?

Mr. **Stringer**. Under the contract, the guarantee agents that these loans are distributed out to will be less than 5 percent, so they will be at 100 percent reinsurance.

Senator **Nunn**. So the Federal Government was reimbursing HEAF 80 percent of the default, and now we are going to move to reimbursing 100 percent of the default?

Mr. **Stringer**. They were not reimbursing HEAF at 80 percent because HEAF was playing what we call the arbitrage game and keeping the loans that had defaulted and were not submitting them to the Federal Government. They were holding them until after October 1, then submitting them and getting 100 percent.

Senator **Nunn**. There is nothing wrong with that?

Mr. **Stringer**. There is nothing wrong with it.

Senator **Nunn**. They can do that.

Mr. **Stringer**. That is approved.

Senator **Nunn**. Why is that? What is this 80 percent business, then? It doesn't seem to have any teeth to it; it doesn't seem to be working. In other words, you are saying to an agency, "look, if you get to a high default rate, we are going to penalize you and we are going to reimburse you less. If you lose $1,000, we are going to reimburse you only $800; you're going to have to eat the other $200." Isn't that the philosophy behind the guarantee program?

Mr. **Stringer**. That's right.

Senator **Nunn**. OK. Now HEAF has basically gone out of business, and you are going to have new people take those over, and you're going to go back and reimburse them the $1,000.

Mr. **Stringer**. Yes. My point is that——

Senator **Nunn**. So the taxpayers lose $200 on each loan, right?

Mr. **Stringer**. No, no, not necessarily because the system that HEAF was working under was that they were retaining those default claims and holding them until after October 1 and then submitting them, and then the Federal Government——

Senator **Nunn**. So the 80 percent reimbursement was a farce, anyway?

Mr. **Stringer**. It became a farce.

Senator **Nunn**. So what good is all of that?

Mr. STRINGER. Most of the guarantee agencies that hit the 90 percent continue to submit their loans and collect the 90 percent; but at the 80 percent level that is too costly, and so they hold the loans. So the penalty at 90 percent is still an operative penalty. At 80 percent, it becomes a game of holding the default claims and waiting until after October 1.

Senator NUNN. Well, the program seems to be just a joke, then, isn't it?

Mr. STRINGER. Well, no, I wouldn't put it that way.

Senator NUNN. The 80 percent part of it seems to be a joke.

Mr. STRINGER. I think one of the purposes of the default penalty as I would see it would be to put pressure on the State agencies—many of the State agencies are actually vehicles of the State legislatures—to put some pressure on the State legislatures to take some concern about the default rates, because after all, their agencies are the ones that are going to be penalized, and they can take that tightening down approach to it through their State licensure. So there is some effect at the State level that we see as beneficial.

Senator NUNN. The bottom line, though, is that the taxpayers are now going to reimburse these HEAF loans on a 100 percent basis.

Mr. STRINGER. That's correct.

Senator NUNN. So that in the final analysis, the taxpayers have been guaranteeing 100 percent in effect.

Mr. STRINGER. Well, that is——

Senator NUNN. You have to ask the question what role are these agencies playing out there if they don't have any capital, those that don't have capital, and if there is nothing to stand behind them if they go down to the 80 percent level, and the Federal Government has got to come in and pick it up. What would be the difference in the Federal Government just doing it to begin with?

Mr. STRINGER. Well, they perform obviously a very important role in the administrative procedure of assuring due diligence and assuring a stability in the market absent a HEAF concern.

Senator NUNN. But the word "guarantor" is somewhat of a misnomer, isn't it, because it's really the Federal Government guaranteeing.

Mr. STRINGER. Well, the Federal Government through the reinsurance program of course adds a lot of stability to it.

Senator NUNN. Senator Kennedy, I know you have a busy schedule and a whole lot to do this morning in other areas, so we'll defer to you now for any observations you'd like to make.

OPENING STATEMENT OF SENATOR KENNEDY

Senator KENNEDY. Thank you very much, Mr. Chairman.

I want to commend you and Senator Roth and the Committee for the excellent work that is being done on what is really the backbone of higher education for millions of young Americans.

I think it is particularly appropriate that these hearings are taking place now, because under the proposal that has been put forward to deal with the budget needs, we have been asked to cut $2 billion from the GSL program. In the next few days, we will be making recommendations both to the Budget Committee and to the Senate on this very important program. So these hearings are enormously helpful. We want to work closely with you and Senator Roth and the other members of the Committee so that we can benefit from your interest and experience with this program and learn how we can ensure that needy students can get the kind of support that they need, how we are going to be able to give assurances that they can receive quality education in quality schools, and how we can ensure that the program is going to be run well.

Let me just mention briefly, Mr. Chairman, that the history of the administration of this program has not been a successful one. That has been the case under both Republican and Democratic administrations. Of course, the problems have become much more acute in more recent times because of the program's dramatic shift from grants to loans. Seventy-five percent of education support in 1975–76 was through grants while only 25 percent was through loans. This has virtually been reversed.

That doesn't mean that a grant program going to lousy schools isn't as much of a ripoff for the taxpayer, and to the student; it is.

Unless we are going to really deal with the fraud and abuse that has been demonstrated over recent years—primarily because of lax administration—then we are not going to gain the confidence of the American people to support or expand these programs, especially under tight budgetary considerations. So it is absolutely essential that we deal with the whole question of fraud and abuse.

I want to assure the Secretary that we are prepared, as the authorizing committee, to give all of the necessary authority to the administration. And I want to join in commending Secretary Cavazos for moving along and trying to use much of the existing authority. It is still taking a good deal of time to implement. In November of last year, we gave the authority for closing down those schools, virtually overnight, so the administration could deal with some of these abuses. It still took until September of this year to develop the necessary regulations to use this authority.

There were earlier references to the National Student Loan Data System, authorized in 1986. The Administration made some recommendations to our committee to give them more flexibility; we did it in 1989, and as Senator Nunn pointed out in his questioning, the time taken to draft and shape the necessary regulations will prevent the system from being implemented until 1993.

So as the problems become more acute, we welcome the opportunity to work with the Secretary in giving the Administration the authority it needs. We want to do this. And we want to make sure that they use the existing authority.

If you look over the audits and inspections that took place prior to Secretary Cavazos during the time of Mr. Bennett, the number of institutional and lender reviews declined dramatically in the mid-1980's, we found that one-fourth of the institutional reviews were made that were made in 1981. And now we see a rather significant increase under Secretary Cavazos in the reviews of guarantee agencies.

But I will say that unless the Department is able to have modern technology, as you pointed out in earlier questioning, and unless they are going to implement administrative authority, we are in a situation similar to the savings and loan tragedy. The S&L debacle will continue to cost the taxpayers for another 20, 30, 40 years. The come-uppance time in the GSL program is much quicker.

So the urgency for effective administration and for holding the department accountable for implementing the existing legislation is absolutely necessary if we are going to be able to one, protect the taxpayers and two, ensure that children in this country can get a decent education.

I won't take the time of the Committee, but I would like to ask the Secretary about the various review.s I am glad that you estimate you will have three or four times as many as you did under Mr. Bennett, when I think quite frankly—and with all deference to Mr. Bennett—that there were serious administrative problems. At the time, we had hearings and went over these issues with him.

As part of the budget reconciliation of 1989, Congress approved a number of changes in the student loan program that were specifically requested by the Administration. A few weeks ago, I received a letter indicating you will not publish the final regulations to implement these changes until June 28, 1991, one and one-half years after we approved the legislation. As you know, you are required by the statute to publish the final regulations within 240 days.

Obviously, some regulations take longer. However, in this case, it seems well beyond the point of reasonableness. This is one of those examples of administrative authority not being used. Is there anything you can tell us about this, Mr. Secretary?

[The prepared statement of Senator Kennedy follows:]

Prepared Statement of Senator Edward M. Kennedy

Mr. Chairman, I am honored to join the Subcommittee at this hearing on the Guaranteed Student Loan Program.

I commend you for the extensive hearings you have held on the program and your thorough analysis of the public policy issues that need attention.

Providing student financial aid is one of the most important activities of the federal government, because it is an investment in the nation's future. This year, $18 billion in such aid will be available to help students meet college costs. Almost half the nation's college students rely on these programs.

But these hearings have made it clear that there are serious problems in the Guaranteed Student Loan program. School officials have cited the Fifth Amendment and refused to answer questions about their schools. One official said that if an individual could "breathe, scribble his name and had a driver's license," he was qualified for admission to the school. A banker blamed "everybody' for student loan defaults, but refused to recognize his own responsibility for the problems that plague the program.

Millions of students benefit from these loan guarantees, but too many do not. Often they are lured into signing up for loans to pay for a worthless or a non-existent education. Yet, the students most likely to be victimized by these scams are those we most want to help.

It is clear that the current system does not protect students, and it does not protect taxpayers either. Total federal insurance costs to cover defaults have increased from $239 million in 1980 to $2.4 billion in 1990. There will always be some defaults in any loan guarantee program. But the amount we are spending now on student loan defaults is unacceptable.

In recent years, the Senate has passed legislation on four different occasions to reduce the cost of these defaults, and legislation to cut student loan defaults by an additional $2 billion will be part of the pending deficit reduction legislation.

We need to reform both the structure and the administration of the student loan program. The Congress has enacted some important legislation and Secretary Cavazos has put some worthwhile initiatives in place. But we must ask whether incremental reforms are enough, or whether fundamental changes are needed.

As we think about such changes, it is important to keep in mind what this program should provide:

(1) Financially Needy students must have access to loans.

(2) The responsibilities of the participants—students, schools, lenders, state agencies, secondary markets and others—must be clear, widely understood and effectively enforced.

(3) Only quality schools that meet specific standards should be eligible to participate.

(4) Students who participate must have the opportunity to receive a worthwhile education.

(5) The program must be administered efficiently and effectively to assure that tax dollars are well spent.

We have done a good job of ensuring that needy students have access to loans. But, if we are frank, we have not done a satisfactory job in the other areas I outlined. The same combination of lax standards and loan guarantees that provoked the S&L scandal is operating here. Students fleeced by fly-by-night proprietary school profiteers are not deadbeats—they are victims of education fraud. The best way to stop the defaults is to stop the frauds.

Improving access to higher education is not a liberal or conservative goal, but one that every American shares. In this era of limited budget resources, student aid programs work that do not work effectively are not likely to be funded adequately. The work of this Subcommittee is helping Congress and the country understood the problems and abuses in the current program. I look forward to working with you to correct them.

Secretary CAVAZOS. First of all, Senator, I want to make very clear our intention and expectation of working with you on that higher education reauthorization. I think that there is where we can start making a lot of the fundamental changes in trying to correct the system.

I must say that you are right on target in terms of lender reviews, institutional reviews, guarantee agency reviews. We have markedly increased those within the last year, year and a half, and that is all to the good, but that doesn't mean to say we can't do even more. We are in trouble, frankly, in terms of our data systems, and we are trying to get those up-to-speed. We are short on personnel, as I presume every department is, to address these issues. We have repeatedly asked for increases in those areas, and we usually end up about 3 percent below what we ask for in terms of our personnel requests.

In terms of what we can really do, though, to initiate real change, we have to work together. You people pass the laws and we write the regulations. I am as frustrated as you are that it takes that long. I can't believe how long some of those regulations take, and I am going to ask General Counsel to respond specifically to your question because I have asked him the same question, and I'm not sure that we have an answer.

Mr. STRINGER. I don't have an answer, Senator, but we will certainly look into the question that you pose and get back to you in writing.

[Subsequent response from the U.S. Department of Education follows:]

The Act mandated a number of changes in the administration of student aid programs, during the middle of the processing year, that required us to give guidance to affected parties through the development of four "Dear Colleague" letters to participating institutions. In addition, the Department issued regulations needed to implement the emergency action authority contained in the Act, and was also required to implement a special loan payback program. Finally, we were faced with the challenge of developing a policy for managing the financial failure of the Higher Education Assistance Foundation. We will be shortly publishing a notice of proposed rule making to implement other provisions of the 1989 Act; and intensive work already has begun on regulatory documents needed to implement the provision of the Omnibus Budget Reconciliation Act of 1990. Most importantly, we have put in place improved tracking procedures and timelines to ensure that last year's delay will not be repeated.

Senator KENNEDY. Well, Mr. Chairman, we will certainly work with you to review the implementation of legislation that has been passed and try to see if we can get these things to work in a more expeditious way.

The area I hope that the Department will be thinking about—and you touched on it in your questions about proprietary schools—is how we can tell the good schools from the bad schools. We've got good ones and bad ones in my State. We have some of the finest in the country. They teach special skills and have just been absolutely superb. They have student repayment rates equal to any of the great schools and universities in the country; others are not so good. One of the things we are going to be working on with you in the next 2 or 3 days is how to develop ways to preserve the good schools and get rid of the bad ones. I hope your people have been thinking about this because we are going to be calling on you to do it.

Thank you, Mr. Chairman.

Senator NUNN. Thank you very much, Senator Kennedy.

The two areas that we really haven't focused on yet in these questions that we really are going to have to all struggle together to find the answers to are accreditation, to try to get to the quality of the schools—you are absolutely right, some of them are superb and some of them are terrible, some are in between. But the accrediting agencies that we have looked to to do this simply aren't doing the job. Now, that doesn't mean we throw them all out. Some of them are doing better than others, and I am certain in some areas they can do better than others. But frankly, you need educators, and you also need investigators. Some people in education are members of the mob, in effect, the new mob. It is a different kind of investigator to deal with an educator who may have problems and not be a completely good administrator and someone dealing with a crook who is in it to basically rip off everybody and leave with the money. Those are two different types of people, and we are going to have to have both.

The State licensing agencies don't have—some of them are doing a very good job out there—but they don't have the incentive. We are going to get into this with the Secretary. They really don't have a financial stake in the program, and that is a real challenge—how do we give an incentive for these licensing agencies to ensure the quality component of education.

I also believe you are right on target, Senator Kennedy, when you talk about trying to find some ways of getting some early warning on these "bad apples." That gets to the data situation. The Department of Education has to have updated computer capability that can kick in very quickly, with warning signals and warning bells on—probably default rates is one of the quickest, but there are a lot of others out there. Right now, the number of guaranteed loans in the proprietary area is a warning bell, and I think we are probably going to see on Nebraska II—we are checking now for those numbers on default rates, but our view of it is—and we don't know yet—that when you get that many loans on a proprietary basis, 90 percent, that you've got another disaster right around the corner. We'll be checking on that. So this data situation is awfully important.

We will have a series of recommendations, but we also know that you know and your Committee knows far more about this than we do. We have been in the investigative part of it, and there is also a whole quality of education part of it that we have touched on, but certainly don't have expertise in. So we will look forward to working with you. And it is not one of those things that is 2 years off; we're going to have to do it in the next few days. I will have a series of recommendations to share with you, and I'm sure Senator Roth will have some, too.

Secretary CAVAZOS. Thank you very much.

Senator KENNEDY. Thank you very much. I appreciate the courtesy of the Committee, and I thank the Secretary.

Senator NUNN. Senator Roth.

Senator ROTH. I want to thank Senator Kennedy for joining us because I can think of no area of more critical importance than the area of education.

What bothers me so much is that as we investigate these problems—and we are all guilty of this—we look at things after the fact. What we really ought to be concerned about is constructing these programs so that we aren't putting students at risk. The real tragedy is that not only do some the students end up in debt, but they also receive a shoddy education.

I personally am not of the school that adding 1,000 regulators will solve the problem. I conducted an investigation into the Medicare program recently which revealed many similar types of problems. We need reforms that will help ensure that problems in these programs won't arise. In other words, we want to prevent problems before they happen, not after the fact. What bothers me is that every student who gets a shoddy education is scarred for life.

I worry, Senator Kennedy, that we have set conflicting goals in our program which makes it very difficult for the program to be efficient. How can we expect to reduce a high rate of failures, and at the same time, demand accessibility to everybody? It seems to me that we've got to really look at what the basic objectives of the program are.

Let me ask you——

Senator KENNEDY. Would you yield on that point, Senator?

Senator ROTH. Yes, Senator.

Senator KENNEDY. I think there is much to what you say. When the program was first established, it was really intended to give access to needy young Americans. What has happened is in a sense it has been successful in this respect, and that this access has brought forward a lot of fly-by-night schools.

Senator ROTH. Absolutely.

Senator KENNEDY. In the sixties and seventies, when it was first implemented, you didn't have fly-by-night schools. You had a few, but basically this wasn't a problem. Now, with the accessibility which has been made available under these programs, we see many more of them. This isn't the only problem, and no one is trying to simplify it. But one of the results is that we are now concerned about, the quality issues, accreditation and so on. This is I think probably partly a result of the success of the program in this limited area. You have opened up accessibility to so many young people, which is really one of the things that we wanted to do. Now we have this other dilemma, which is enormously complicated, as the Chairman and as you have pointed out.

I don't want to use this as an excuse for not addressing the very serious kinds of questions that you are addressing and which all of us are concerned about.

Senator **Roth**. You see it time and again, not only in this program, but program after program. We see that somehow the con artists, with some clever lawyers, find access to the U.S. Treasury. Frankly, I think that is part of the problem here, that some smart operators have seized upon the situation. There has been an explosion of new proprietary schools in the program, or the growth of the old ones far beyond the "mom and pop" schools that they were, and why? Because they had access to the U.S. Treasury with no risk.

And I'll be frank—I don't think adding 1,000 regulators or a lot more rules and regulations is going to solve it. I think there is a basic problem in Government. I think that is what the American people are asking—can we manage? I think that is probably the most serious question that faces Government today in many ways.

But let me go back and ask you——

Senator **Nunn**. Senator Roth, I think there is a balance here. We heard testimony about a week ago out in the regional office. We had, I think, three people with four States to cover and 1,400 schools, and very restricted travel funds. Now, that is far from over-regulation. I said somewhat facetiously that about all they could do was fly over the schools.

So there is a balance here, and that is where management comes in; someone has to say what is a reasonable number of people to administer a program of this size, and someone has to say what kind of training those people have to have. And that is what we have to look to the Secretary and his team to do, and also to the Office of Management and Budget.

So even though I agree with you that you don't want massive new regulations and rules, if you don't have qualified people administering the program, you shouldn't have Federal money in it, because you are not going to rule out corruption. There is no law that you can ever pass saying that this is a program that we don't want the mob to tinker with, because if you put enough Federal dollars out there, you're going to find a crook to follow it. That's an inevitable rule of human nature and always has been.

Senator **Roth**. I would agree with you, Mr. Chairman, that there are circumstances and situations where the funds may not be available. I have to say, having served on Governmental Affairs for many years, I am always astounded at the billions of dollars used in travel by the Government. So it seems to me that somewhere those funds ought to be available.

I want to return to the question where there are a number of new institutions that are very dependent, 80, 90 or 100 percent, on student loans as a means of financing. Should they somehow be treated differently from other institutions that are not so dependent on this Federal program?

Secretary CAVAZOS. Senator, I think what we need to do is to treat them all the same, and let me explain why I say that. Coming back to the issue of access, the thing I am going to emphasize is something that we have never done before, at least in our Department, here, in terms of the student loan defaults; that the solution really lies in the quality of the institution, establishing quality institutions out there that meet the requirements, whether proprietary or higher education schools or vocational schools, and secondly, making those schools accountable for what they are doing.

The only way that I would treat those schools that are 100 percent dependent on student loans—I would watch for warning flags very, very quickly—100 percent, 90 percent, whatever, we know that they are out there. But part of the issue is that we are only dealing with a handful of schools.

I think that now we have that authority to start closing some of these schools where the quality is not there. I have also been trying to approach it through the accreditation issue. As I pointed out in my discussion, there are 96 accrediting agencies out there, and there are about seven that are the major set of problems. This go-around, five of those seven are up for review in terms of renewal of their accreditation with the U.S. Department of Education. I have sent back to the committee two of them for a further look, and the rest are going to be going back as they come up for their renewal.

So while I'm trying to approach this whole issue thru the accreditation process—the other side of it is we're going to have to do a better job in terms of licensure. The States have that responsibility. I need to really get together with the Governors out there to say we've got to pull together on our whole license issue. It is so fragmented in the different areas. For example, the truck driver schools in some States are licensed under the Department of Transportation. The associated health professionals perhaps come in under Public Health. They are not in the Department of Education.

So those are the kinds of problems that we have out there, and what the whole issue gets down to is we've got to find ways of pulling all of these actors together. You are right that you can't legislate people stealing and what they are doing, but we certainly feel that we can do a better job—I know we can do a better job. Counsel here reminds me that we do treat trade schools differently from others as to the issue of the clock-hour/credit-hour certification. Some of them tended to stretch out those course hours to fill the bill, and now we have stopped that. And the branch campuses—they used to create branch campuses, and they would automatically take the accreditation with them—we have also stopped that.

Senator ROTH. It seems to me that there is a great deal of difference between some proprietary schools and the established 2- or 4-year colleges. Once the door was open to the U.S. Treasury, there was a great burst of new proprietary schools, some of which I am sure are excellent and provide the kind of education we desire for our young people. At the same time, we cannot ignore the fact that many of the problems in the student loan program are concentrated in the proprietary schools. I am not worried about accreditation of the University of Georgia or University of Delaware, but I have to say that the system in my judgment does not seem to be working as far as the proprietary schools.

I'm not certain what the answer is. Perhaps your meeting with the Governors will be helpful because that's where the action is. At the same time, it seems to me that we must address the differences between the proprietary schools and the community colleges and the 4-year institutions, and consider different treatment for proprietary schools.

Secretary **Cavazos**. Well, coming back to the point that I made, the key therefore is in that "triad," the State and the accrediting agency and the Department of Education, working together to bring that accreditation and certification and licensure into proper prospective.

I'd like to ask John Childers, from our postsecondary area, to talk a little bit about the accreditation and some of the issues we have there.

Senator **Roth**. In answering this, let me just ask one further question. In testimony before this Subcommittee on September 13th, John Hayworth from the Illinois State Board of Education and Sam Ferguson from the Florida Department of Education both stated that they had more problems with accredited schools than with unaccredited schools.

Would you agree that the accreditation system has failed to weed out the "fast buck" operators?

Mr. **Childers**. Well, Senator, I have a little trouble making that comparison because we don't deal with unaccredited schools in our Title IV program, so they are just unknown to us in terms of administration of programs.

A couple of thoughts on how to distinguish schools or weed out bad schools and then comments on accreditation as well, responding to you and to Senator Kennedy.

Earlier this summer the Department asked me to see if there was a way to focus on the abusive schools and to coordinate our efforts in that regard. By marrying lists of high default rates as well as high volume of defaults, which of course is the cost to the Federal Government, we arrived at a list, as the Secretary has described, of less than 100 high default rate/high default volume schools. Specifically, 89 schools accounted for almost $400 million, or 30 percent, of the defaults in the FY 88 cohort.

Since that time we have focused very specifically on those 89 schools. I think it is not just the number of program reviews you are doing, but whether or not they are focused program reviews. Since that time, a number of those schools have closed; our program reviews are working on those schools, our certification efforts are focused on those schools; our look at accrediting agencies is focused on the files of those schools, and we continue to work on that effort.

Now, 84 of those 89 schools were proprietary schools; there were five schools that were 2-year and 4-year colleges. But I think even if the rules are the same, you will have differential results, and it just so happens that we are focusing on the proprietary schools at the present time in our reviews.

Similarly in the accreditation area, I think it is important to note there are 3 major types of accrediting agencies, and, as you have already noted, we don't seem to have much of a problem with the large regional accrediting agencies that accredit colleges and universities, such as The Middle States Accrediting Association that accredits the University of Delaware and other institutions there.

In addition we have specialized accrediting agencies such as the American Medical Association, which accredits medical schools; the ABA, which accredits law schools; and associations that accredit architects, engineers, nurses. I think the focus is the seven national proprietary agencies that accredit the trade and vocational schools in this country.

The Department has called those 7 agencies into the Department this summer. The Undersecretary, Ted Sanders, and the Assistant Secretary for Postsecondary Education, Leonard Haynes, have met with representatives of those agencies and have told them that a major focus of the Department is going to be student outcomes, the results of those students in those schools, and that default rates are going to be one of the items that the Department and the National Advisory Committee on Accreditation are going to be looking at as part of the review as to whether or not those agencies should be recognized by the Department and should be considered as reliable authorities on the quality of education.

Senator ROTH. Going back to an earlier point I made, one of my great concerns is how do we keep these "flim-flam" schools out of the system.

Mr. CHILDERS. May I speak to that as well, Senator. There is one other thing I should have mentioned in my talk about what we are doing——

Senator ROTH. Let me just finish, and then please go ahead. I am also concerned, for example, about cases like the Culinary School of Washington which went on for years, unbelievably long, without any action taken. At the very time that this Subcommittee was bringing the owners of the culinary school to testify before it, they were involved in other efforts to create similar schools.

What are you doing about debarring or disbarring bad actors from further participation in this kind of a program?

Mr. CHILDERS. That was part of my look at the program this summer. On August 24—I can precisely date it to the afternoon of August 24—we stopped the practice in the Department of certifying branch campus eligibility automatically.

It was true that until then, a branch application from a certified institution would pass through the certification process without recertifying the stability of the parent institution. That will no longer happen. All institutions have been put on notice that branch campus applications will no longer be automatically approved without going back and looking at the financial stability of the institution as a whole.

Mr. HAINES. One thing we have instituted recently is that for any stockholder who has 5 percent of the stock of a corporation that is purveying educational services, we require the name of that person, and then we run those names up against the GSA list of individuals who have been debarred. So that is another thing that we are doing to check to try to get some control——

Senator ROTH. Do you debar somebody who has a bad record? Have you done that?

Mr. **Canellos**. Senator, may I answer that? I think the point of reference that you made to the Culinary School, the answer to that is that the doctor and I think his wife—maybe just the doctor—has been debarred, or at least the notice of intent to debar has been submitted.

Now, we do in the Department participate in the Government-wide debarment process, and for those types of offenses which are usually the serious types of offenses, we do actively debar people. I think our numbers are 24 last year and 58 this year.

Of course, the process still entails a hearing and so on, but we do participate in that program.

Senator **Nunn**. Senator Roth, would you yield on that, because the word "debar" is being used here—what does that really mean? What do you mean by that?

Mr. **Canellos**. The debarment process is a Government-wide process in which if you are on the list, you are not allowed to contract with the Government nor are you allowed to receive grants from the Government and the like.

Within the Department, that hopefully means that a person who is on that list cannot enter into an agreement with the Department for student aid in another school that he runs.

Senator **Nunn**. But you don't have any cross-check between accrediting agencies, do you? If one accrediting agency takes steps to take someone off the list, that doesn't mean they can't shop around and go to another accrediting agency.

Mr. **Canellos**. If I understand the question——

Senator **Nunn**. That's short of debarment, now.

Mr. **Canellos**. No. The accrediting or licensing part of it, I am not capable of answering that. But I know in the debarment process it is Government-wide once it is accomplished. Short of that——

Senator **Nunn**. Short of that, you can get away with almost anything. We've got a case here, Senator Roth, right on the point you are talking about. Mr. Anatoly Bidney, owner of the National Technical College, has lost his accreditation from two different accrediting bodies, but has recently purchased another school which is called Westwood Educational in Michigan—Senator Levin. An accrediting body different from the other two has approved this purchase and associated change in the school's name. As of September 12, 1990 this school has been declared eligible to participate in Federal Guaranteed Student Loan Programs.

National Technical College is now subject to a $1 million civil suit brought against it by the State of California for false or misleading advertisements, abuse of ability to benefit tests, misrepresentation regarding prospective jobs, training offered, student financial aid, failure to refund students' tuition and fees.

Now, there has got to be some system in the Department of Education to cross-check these things. There has got to be some correlation between accrediting agencies. We can't wait for debarment to take care of this. There has got to be some step taken where if one accrediting agency takes affirmative steps against somebody and disqualifies them, there has got to be some kind of cross-check. I don't know the exact procedure, but there is no procedure now.

Mr. **Haines**. There are a couple of things in response to that. I'm not sure of this particular instance that you are talking about, but if this person shows up and finds that he has an institution that is accredited, and then applies for eligibility, if that person has actually been debarred and is on the debarred list, that should keep him off the rolls of institutions participating in our programs.

Senator NUNN. But you are back to debarment now. I am short of debarment, saying the accreditation has been taken away. That is two different things.

Senator LEVIN. Or denied.

Senator NUNN. Or denied.

Secretary CAVAZOS. If they lose their accreditation by an accrediting agency, then they have to wait 2 years; they can't shop around and find somebody else to accredit them. We just got that authority in December of last year. So now they can't go out and shop around.

Senator NUNN. When has that been implemented, Mr. Secretary?

Secretary CAVAZOS. It has been implemented.

Senator NUNN. Well, this is dated 9th month, 12th day, 1990, U.S. Department of Education, and this is to Mr. Anatoly Bidney, owner and president, Westwood Educational.

> Dear Mr. Bidney, We are pleased to inform you that based upon the information included in your application, the Secretary of Education has determined that Westwood Educational, located at 144 West Lafayette Street, Detroit, Michigan, satisfies the definition of eligibility of proprietary school and——

Secretary CAVAZOS. They had lost their accreditation, Senator?

Senator NUNN. By two different agencies.

Senator LEVIN. Mr. Chairman, excuse me. I think that you are not addressing the question of where they were denied accreditation.

Senator NUNN. Accreditation was withdrawn.

Secretary CAVAZOS. Where it was an accredited school and they lost their accreditation—it was withdrawn.

Senator NUNN. Yes, that is what has happened in this case. It was a different school; it was called National Technical College. Same players, different piano.

Secretary CAVAZOS. All right.

Senator NUNN. There has got to be some system——

Secretary CAVAZOS. If they hadn't changed their name, they couldn't have gotten back the other way—I understand.

Senator NUNN. It is the same outfit.

Secretary CAVAZOS. Let me just assure you, Mr. Chairman, that we'll go back and look at that one again and let you know what happens. [See Exhibit No. 4.]

Senator NUNN. Well, I hope you'll look at this case, but it goes far beyond this case. There has got to be a cross-check here. There has got to be a database. The accrediting agencies—you have to have a system where they give you notice, and then you have to be able to disseminate that to other accrediting agencies. It all has to fit together.

And of course, we have been told that your whole database is only about 50 percent accurate, and so if that is the case, then even if you have a system, and you have incorrect information in it, it is not going to work. So you have just really got to get this situation straightened out.

Mr. **Haines**. Speaking to that again, as I said, we have made great progress this past summer in getting the hard copy data up, and when we do have that up and the system is working, all accrediting agencies and the Department of Education and the licensing agencies and the guarantee agencies will all plug in and be connected to this network of data. So any instance such as that will be found either by the Department or the accrediting agency, or both, or any other party involved.

Senator **Nunn**. When, Mr. Haines, when?

Mr. **Haines**. I would say that within the next 6 months, all of those—in fact, indeed, all of those systems are in place right now. And as soon as we get the database completely up-to-date, which I would say is by the end of this calendar year, all of that cross-checking can be done just on that IDS system.

Senator **Nunn**. You have been over there a long time, Mr. Haines. Why has it taken so long? You have been there 15 years?

Mr. **Haines**. Thereabouts, yes.

Senator **Nunn**. What is wrong? What is wrong with the Department of Education? Why has it taken so long. Mr. Cavazos has been there a year and a half. What has been wrong all along?

Mr. **Haines**. Well, as I was trying to say earlier, I think it is difficult to get interest in developing good management systems in the absence of a crisis, and I think that those are some of the first resources to go in tight budget situations, so it is a much slower process in getting the capital that you need, the equipment that you need and the people that you need to put these things together. I think we in the Department really do need to make a better effort to ensure that we have these kinds of management systems in place, and work on them before the time comes where we are at a crisis stage.

Senator **Nunn**. It must have been frustrating for you to work in that environment for a long time, basically having not much interest in updating or capability until a crisis comes. Have you complained, yourself, to your superiors?

Mr. **Haines**. We have, and as I say, under this Administration, under Secretary Cavazos, we have gotten a much greater response than we have in the past.

Senator **Nunn**. Did you complain to the last Administration? Do you have anything in writing? Did you say that this system is not working? Did you say that you weren't capable of being able to manage it? Did you say the taxpayers were about to take big losses? What did you do?

Mr. **Haines**. Well, I have been in this position for only a couple of years. Secretary Cavazos came onboard and was part of our operation when I went over to the Debt Collection and Management Assistance Service.

Senator **Nunn**. So you have just been there the same length of time he has.

Mr. **Haines**. Right. I think that those issues have been raised over the years——

Senator **Nunn**. Without success.

Mr. **Haines**. Without all that much success, for various reasons, for various reasons. I know the GSL database is something that 15 years ago, we were working to try to get a good system going so we had good data by student from the guarantee agency, and that has just taken a long time to develop, partly because you have 50-some guarantee agencies out there, partly difficulties with respect to equipment, computers, and just resources to go about bringing this all together. And it is an extremely complicated system, as I am sure you have found out in your investigations.

Secretary **Cavazos**. Let me perhaps speak here in terms of some of these efforts that some of these people are doing there. And I have to really point out that in the first week that I was in this job, the recommendations from the prior Secretary had already gone over to OMB; I retrieved those in terms of student loan default initiatives, and in the next few months and close to a year, we put in place the most significant, complete, total overhaul of our student loan default rate, holding institutions accountable as well as students. As a part of all of that, as I mentioned in my written testimony, we asked for certain authority. Some of it we have gotten, some of it we haven't gotten.

The important point here is that I managed to get the Department to focus on the fundamental issue of saying, you know, we're just not going to go for this. So yes, I will take responsibility for what has happened since September 20, 1988, but I really believe, to the credit of a lot of people in the Department, frankly, that we have done a good job. It is a monumental task just even getting these databases up to where they need to be, and we are playing catch-up all the way. And I am not pointing fingers or anything else along that line, but I guarantee you I created a crisis over there in that Department long before you created one over here, as my good colleague over here insists.

So therefore, I am confident that given enough time, we can get this thing turned around. I keep coming back to where are the points that we can affect. We are going to affect the accreditation, the licensure, and we're going to really look at these schools very carefully in terms of certification. But we need the authority. And I would like very much to work with the Congress to get us that new authority, and then where we really can be effective is in the higher education reauthorization.

If we let this chance pass us by, it is our fault.

Senator **Nunn**. Senator Levin?

Senator **Levin**. Thank you, Mr. Chairman.

Is this repository of information, this database which you are creating, going to include information when accreditation has been denied—not withdrawn, but denied?

Mr. **Haines**. Yes, sir, it will.

Senator **Levin**. But it does not now do that, is that correct?

Mr. **Haines**. I think that is correct, yes.

Senator **Levin**. And why does it not do that now?

[No response.]

Senator **Levin**. That is the "shopping" which I think the Chairman and others have been talking about, or at least one form of it; there are many forms of it. You seek accreditation, and you are denied. You go and seek accreditation somewhere else, and you are denied. You go to a third place, and they don't even know that you have been denied twice before, because it is not in the database. Now, why isn't that part of our database now, so that where there is an application denied, that information goes to that central repository?

Mr. **HAINES**. When the Department of Education denies an application, that will certainly go on the database. When an accrediting agency denies the application——

Senator **LEVIN**. I'm talking about accrediting agencies.

Mr. Haines [continuing]. Then we need the cooperation with the accrediting agencies and a good communication system with them so that they——

Senator **LEVIN**. My question is why haven't you told the accrediting agencies to let you know whenever they deny an accreditation. That is my question.

Mr. **HAINES**. I believe we have told them to do that. I don't think that we have full cooperation in all cases that is true. We are working with the accrediting agencies. They have their own system on here, and we'll be connected to the system. And I think that along with the State licensing agencies, the accrediting agencies and so on plugging into this system—we all have a stake in this——

Senator **LEVIN**. Let me just ask—when you say you've told them that you want to be notified when accreditation is denied, is that by regulation that you have instructed them to do that?

Mr. **HAINES**. No. They are not required by regulation to notify us.

Senator **LEVIN**. My question is why. You don't need any authority for that.

Mr. **HAINES**. Well, one of our initiatives will be indeed to require—I do believe we do need some authority to actually require that this information be passed on from the accrediting agencies or State licensing agencies to the Department——

Senator **LEVIN**. Don't you approve these accrediting agencies?

Mr. **HAINES**. Yes, we approve the accrediting agencies.

Senator **LEVIN**. Then why can't you make that a condition of your approval that they notify you when accreditations have been denied?

Mr. **HAINES**. I believe we will, and I believe——

Senator **LEVIN**. Not "will"—why do you need additional authority to do that?

Mr. **HAINES**. John, can you speak to that?

Mr. **CHILDERS**. It is not in the regulations under which the accrediting agencies have to comply. It is not——

Senator **LEVIN**. Do you need any additional legislative authority to require that?

Mr. **CHILDERS**. You could probably do it by regulation.

Senator **LEVIN**. Of course. You don't need additional legislation.

Mr. **CHILDERS**. No, you do not need additional statutory authority for that.

Senator **LEVIN**. Okay. My other question relates to default collection. Right now we have a situation where these guarantee agencies can serve both as guarantors and collectors on defaulted loans. So you've got an entity which is a guarantee agency, the loan goes into default, the guarantee agency pays off the lender. If 180 days goes by, it in turn is reimbursed by the Government.

Secretary **CAVAZOS**. If they show due diligence in their collection, yes, sir.

Senator **Levin**. Do you mean that you have a lot of cases where collection agencies have been denied their reimbursement by the Government for failure to exercise due diligence?

Secretary **Cavazos**. Not collection agencies; guarantee agencies.

Senator **Levin**. Where the guarantee agencies have been denied their reimbursement?

Mr. **Stringer**. The guarantee agencies are required to do a number of things during that 180-day period in order to qualify that loan for reinsurance, and if they don't do it, there is no reinsurance.

Senator **Levin**. If they don't collect the loan within 180 days, they are then paid off by the Government?

Mr. **Stringer**. That is correct, if they have done their due diligence.

Senator **Levin**. Yes. Do you know in what percentage of the cases they have not been paid off by the Government?

Mr. **Stringer**. No, sir, I don't.

Senator **Levin**. Would it be a very small percentage?

Mr. **Stringer**. I would suspect it would be a relatively small percentage. But it is a mechanism that we have, and we control it, and it works. If it isn't done, they don't get reinsurance.

Senator **Levin**. Well, it seems to me there is an incentive not to go out and collect that loan during the 180 days, because they then become the collection agency after 180 days and can keep 30 percent of what they collect, as well as having been paid off in full by the Government.

There is a conflict of interest which is inherent there, because they get the money from the Government, and then after 180 days, they can go out and collect and get 30 percent of what they collect.

The incentive that is built in is to wait the 180 days, get paid off in full, and then go after the loan.

Let me just tell you that your own IG has said in response to this concern of mine that "although we have no statistics or examples, or even a reason to believe that guarantee agencies favorably permit or encourage defaults, it may be economically sound for a guarantee agency to allow loans to default in order to be able to collect them afterwards. This disincentive for aggressive default prevention does appear to be a weakness in the current guarantee agency structure. Guarantors that do not hit the triggers may not have financial incentives to reduce defaults, and may in fact have strong incentives to allow them to occur."

Do you agree with the IG?

Mr. **Stringer**. No.

Senator **Levin**. Okay.

Thank you, Mr. Chairman.

It is your own IG.

Secretary **Cavazos**. We don't agree with him.

Senator **Levin**. Have you told your IG you don't agree?

Mr. **Stringer**. We have discussed this, and the reason I don't agree is that there is a significant risk that that loan won't be collected and that the guarantee agency will have it included in its default rate and will wind up with nothing.

Senator **Levin**. The only way that would be true is if there indeed is a significant risk, and that is going to depend on those statistics as to whether or not it is a minute percentage that are not paid off in full or a larger one. And I'd like to see those statistics. Would you furnish those to us?

Secretary **Cavazos**. We'll get them for you.

Senator **Levin**. Do you think it is less than one-tenth of one percent?

Mr. **Stringer**. You are talking about statistics on loans that the guarantee agency has paid off on to the lender and that are permitted to go into some kind of due diligence breakdown?

Senator **Levin**. Where you deny them reimbursement because they haven't shown due diligence.

Mr. **Stringer**. Okay. Certainly, we'll get that for you.

Senator **Levin**. Do you think it would be one-tenth of one percent?

Mr. **Stringer**. I don't know, Senator.

Senator **Levin**. Take a guess.

Mr. **Stringer**. I couldn't even guess.

Senator **Levin**. Well, then, how can you say there is a significant risk?

Mr. **Stringer**. No—the significant risk is at the tail end of it when the guarantee agency is trying to collect the loan, and historically some 30 percent of those loans are collected. If the 70 percent are uncollected, then there is no benefit to that guarantee agency at all.

Senator **Levin**. Nor loss.

Mr. **Stringer**. Yes, there is loss, because they are required to expend money to try to collect that loan.

Senator **Levin**. The only way this is going to be provable is if you can show us that there is a significant risk to those agencies by letting it go 180 days; that is going to require that statistic which I just asked for.

Mr. **Stringer**. We'll get the statistic for you.

Senator **Levin**. Thank you, Mr. Chairman.

[Subsequent written response from the U.S. Department of Education follows:]

When a borrower becomes delinquent in the repayment of his or her loan, the lender is required to perform "due diligence" in an attempt to collect this loan. In the GSL programs, due diligence includes a series of collection procedures, prescribed by regulation, which are designed to establish contact with the borrower for the purpose of beginning (or resuming) payment. If after 180 days these attempts to initiate repayment fail, the loan is determined to be in default and the lender submits a claim for insurance to the guarantor. The lender's claim for an insurance payment equal to the outstanding principal plus interest balance of the loan must be made within 90 days of the date of default.

The guarantor must reimburse the lender for the default claim within 90 days of the date the lender filed the claim. This time period provides the guarantor with the opportunity to review the lender's claim with respect to compliance with the due diligence procedures. That is, if the lender has performed due diligence, the guarantor then pays the lender's default claim.

The guarantor must wait at least 90 days before submitting a claim for reinsurance (that is, a reimbursement for its own default claim payment to the lender) to the Department. During the first 180 days that the guarantor holds the defaulted loan, there are due diligence-type activities that it is required to perform. In order to receive and retain a reinsurance payment, the guarantor must perform these activities. However, the Department's reinsurance payment to the guarantor is not contingent upon the successful performance of these activities. Rather, "guarantor due diligence" is the set of collection activities which the guarantor must undertake to receive or retain Federal insurance on the loan.

If the guarantor has been successful in its collection attempts, it may retain 30 percent of the amount it collected to help offset the cost of its collection activities. The remainder of the payment is forwarded to the Department. Note that the lender had attempted for six months to collect the loan (lender due diligence). Thus the 30% retained by the agency reduces the cost to guarantors of pursuing loans which have been demonstrated to be difficult to collect.

The amount of Federal reinsurance payments to a guarantor depends upon the default performance of the lenders whose loans that guarantor has insured (the "trigger"). Reinsurance payments to most guarantors equal 100 percent of the default claims they paid to their lenders. However, some guarantors are subjected to reduced reinsurance (i.e., 90 percent and 80 percent). In fiscal year 1989, the Department reimbursed guarantors for 95.3 percent of all default claims the guarantors paid lenders.

The Department does not verify a guarantor's performance of due diligence prior to payment of a reinsurance claim. Improper claims are detected after the fact, that is, during audits and program reviews. Most guarantor due diligence failures are technical in nature and are not considered significant violations. An example of a technical violation is missing a deadline for written or telephone contact with a defaulter. In these cases, the Department requires corrective action by the guarantor, but does not assess a liability.

Senator NUNN. Thank you, Senator Levin.

Shifting to another area of the same general field, the Subcommittee staff heard testimony, Mr. Secretary, that even when program reviews do uncover violations the school is held liable only for the actual findings of that review, with usually no follow-up to determine whether additional violations exist.

For example, if 50 percent of the files reviewed reflect failure to make refunds for students who had withdrawn, we are told the school normally would be asked to make refunds only on the files reviewed, with no other follow-up.

Mr. CANELLOS. Senator, if I could state that we do, on many occasions, based on shortage of time, et cetera, only review a certain number of the files at a school. However, we do apply a sampling technique and often extrapolate out a finding that takes into account the fact that we've only examined "x" number of files and found whatever the percentage rate of problems are. And we have had previous audit findings in that regard. Now, I can't certify——

Senator NUNN. You say you often do it; that implies you often don't do it. It seems to me that when you run into a real problem like this that it ought to be the rule rather than the exception to basically say okay, we found in 25 percent of your cases you didn't make refunds to these students, and not only are you going to have to reimburse those 25 percent, but we want you to go out and prove to us that you've done this with everybody else.

We've got a lot of students out there who deserve refunds who don't get refunds; they are getting hung by the debt they have, they don't have an education, and yet when you find that kind of problem, it seems to me it ought to be rather comprehensive. That ought to kick in a lot more.

Mr. CANELLOS. Senator, let me amplify what I said. I said we sometimes do, but I just checked with staff—we always extrapolate out when there are significant findings. What I meant to say was when they are insignificant findings, we don't do that if it is a small percentage. But in any significant finding—and I grant you that we don't quantify what "significant" is—but in consultation with our staff, we do extend that out.

Senator **Nunn**. I hope you'll check into that, because that is not what the field reviewers have told us. We have been told that it is case-by-case, and if you find basic, big problems or significant problems, that you just require the school to deal with those problems, but not with the more comprehensive.

Would you check on that and let us know after you have checked a little more thoroughly?

Mr. **Canellos**. Yes, I will make that a special point and check it.

[Subsequent written response from the U.S. Department of Education follows:]

When significant regulatory violations are found during program reviews or audits, the Department (ED) routinely requires schools, lenders, and guarantee agencies to conduct complete file reviews or to review statistically valid samples to determine error rates and resulting liabilities. An error or violation is considered significant if it occurs in more than ten percent of files in the sample reviewed. In such a case, we base the assessed liability to the school on a projection drawn from the percentage of items in the sample which were errors or violations. However, if an error or violation is found in ten percent or less of the sample's files, liabilities are assessed only for those specific items in the sample. ED usually requires the results of any statistical sample to be validated by an independent certified public accountant.

Senator **Nunn**. Mr. Secretary, has the Department taken action to improve the National Advisory Committee's role in the accrediting agency recognition process? We had people on the National Advisory Committee who basically said those were basically just political appointments, and we even had testimony that one lady was on the board for a couple of years and kept asking when they were going to start dealing with problems of the elderly; she didn't even know why she was on the board.

Now, is that board something to be treated seriously, or is it a throwaway.

Mr. **Childers**. I can't speak for board members in previous years. In the last two years since Secretary Cavazos has been there, I think the people who have been appointed are people of quality, and they understand what they are supposed to be doing.

This year, we are just appointing for the new year, for example, the State superintendent of public instruction in the State of Idaho; a dean of education at Auburn University; there is a person required to be a student, and we are appointing a Ph.D. candidate at Stanford. I think the people who have been appointed in the last 2 years are people of quality.

Senator **Nunn**. Did you find that in the past, that had not been the case, Mr. Childers?

Mr. **Childers**. I have only been at two meetings this past year, and I didn't find that this year; but I can't speak to the past.

What I can tell you is—this has been done in the past—but we are going to more intensively be briefing the members of the Advisory Committee when they come to Washington for their meetings. This is particularly useful for the new ones. We are going to be telling them that we want them to look more actively at student outcomes which were put into the new accreditation regulations in 1988 and that, as has been mentioned earlier today, we want them to look at default rates as a criterion for possible problems of quality in institutions accredited by any given agency.

Senator **Nunn**. So you are going to treat this Advisory Committee as a serious body?

Secretary **Cavazos**. Very much so. I think, if I may just interject here, John, they recognize how serious we are about turning this problem around, and that they are to us the key because if the approve those accrediting agencies and we in turn certify, we are both partners in the outcome whether it is positive or negative. And just by virtue of the fact that I have already started remanding some of these back to them to look again, even perhaps after, in a couple of cases, they approved it, I didn't like it and sent it back to them.

They are a key committee as far as I am concerned, and as Mr. Childers pointed out, there are really some quality people who have been appointed to that Committee, particularly in recent times.

Go ahead, John.

Mr. **Childers**. I think that was the point. We are going to be bringing the committee members in a day early for intensive briefings this time and to stress the importance of the mission they have.

Senator **Nunn**. I am glad to hear that.

On the subject of accreditation, the Veterans' Administration a good many years ago recognized the weaknesses of accrediting bodies, and they don't use accrediting bodies, I understand, for VA student loans. They use a different system for certifying school eligibility.

Are you familiar with the Veterans' Administration way of doing that, any of you?

Mr. **Haines**. I am somewhat familiar, not all that familiar. Let me say that we did have one of our reauthorization work groups look into the Veterans' Administration model, and they had some folks from the Veterans' Administration come over and brief that group. Basically what they found—and let me back up a little bit here. The Veterans' Administration contracts with State agencies to basically administer the program for them, and they don't look at institutions, but they look at particular programs and approve those programs.

Now, the veterans' benefits are relatively small in comparison to what we are doing in the Department of Education at this point, when you are talking somewhere in the tens of billions of dollars of student aid.

The impression that we were given, that the work group was given, was that to a large extent, the Veterans' Administration would be using some of those same agencies of the "triad," the State agencies that are currently problems for us; secondly, that that program did not work all that well, and indeed the people from the Veterans' Administration admitted to having some problems. And our work group did not think that with the volume of student aid that we do through the Department that the Veterans' Administration model would really hold up under that kind of volume.

Senator **Nunn**. Was that before we pretty well concluded that this model that the Department of Education is using is not holding up? When was this survey done?

Mr. **Haines**. No; I think that it is was more-or-less simultaneously. We have been looking at the "triad" and the problems of accreditation, licensing and certification now for some time in order to prepare ourselves to develop proposals to go forward within this reauthorization. I think everybody understands that there are a lot of problems. Naturally, we wanted to look at the Veterans' Administration as a possible model to adapt for the Department.

Now, while I was not involved in that particular work group, the work group did indeed look into this fairly extensively and concluded that that was not a model that they thought appropriate to recommend to the Secretary to go forward with.

Senator **Nunn**. Tell me who this group is that looked into it?

Secretary **Cavazos**. Let me interject here. In preparation, as I pointed out to you earlier, for reauthorization of the Higher Education Act, I felt that there were several areas we had to touch base with--certainly with the institutions that are out there, Dupont Circle and all of their people. And I created 13 committees within the Department itself to look at all aspects of the reauthorization. The one that Mr. Haines is pointing to dealt with looking at the issue of accreditation and some of the other parts. I had other committees looking at academic quality, others looking at a variety of areas. So it is a major, major undertaking on our part, and it consumed a good part—I guess they worked for almost a year. And we hit the schedule exactly when we anticipated we would, in October, the first of the month or into September, we hit our window and got that all over to OMB. So we are right on target, and those committees have done a grand job. They are looking at many of these things, Mr. Chairman. I think I want to emphasize again for the record and make it very, very clear that that will be the opportunity for us to make significant changes, without having to go back and just patch and patch. That is what we have been doing in the past. Everything you have heard here is a reaction to a problem instead of trying to anticipate and lay it out how you are going to handle it.

Senator **Nunn**. I understand that, and I agree with that opportunity that you have outlined. Mr. Secretary, on this same point, we took a look in great detail at the Culinary School of Washington—I think it later became Rome, Paris, Beijing, and so forth and so on—but it was a school that had big problems. And while this school stayed in operation and was eligible for student loans under the Department of Education, the Veterans' Affairs Department brought charges against the school in March 1986 and entered into an agreement barring them from participating in Veterans' Administration programs.

Now, here in 1986, one department of the Federal Government, Veterans' Affairs, took action against the school, barred them from participating, and your Department continued to have them eligible for student loans until they went bankrupt in 1990.

Two questions there. I think that you need to review further the Veterans' Administration's procedures because it is obvious that the procedures in the Department of Education, using accrediting bodies in this case, and I think it is indicative in many others—maybe not all, but indicative of a lot of others—is not working.

The second question I would ask you is this. Is there a way of correlating records between the Veterans' Administration and the Department of Education; when they take action and debar a school from being eligible for Veterans' Administration educational benefits, do you know about it, and do you take action based on it?

Mr. **Haines**. No, sir, there is not that communication going on between Veterans' Administration and the Department of Education. And it just struck me as I was going through some of this material that one of the things that we could do is connect the Veterans' Administration to our institutional database and share information on a regular basis. We don't currently do that——

Senator **Nunn**. I think you want to get yours straightened out before you'd want to give it to them, though, from what I have heard.

I find that really—here we have two departments of the Federal Government, both of them involved in large amounts of money—yours much more, obviously—both dealing with quality of education supposedly for recipients, and yet you are basically saying there is not even communication between you and them, so that if they debar somebody you don't even know about it. Is that right?

Mr. **Haines**. That's correct, and it is a problem that needs correcting.

Mr. **Canellos**. Senator, I think I see the problem as one in which the Veterans' Administration did not take formal debarment action, because as I understand it if you debar someone, you are on a list that is published by the General Services Administration which is distributed Government-wide; whereas if you take an action short of that, and it is something internal, obviously we don't have a procedure to interface with the VA. Maybe we should, and we should look into that, but that may be where the problem is.

Senator **Nunn**. I believe there was probably some agreement entered into that was short, but whatever it was, they basically took action, and they decided this school was not worthy of having their students go there, and they weren't going to put any money in it, and yet we've got another department of the Government that didn't do it until disaster struck. I mean, if we'd just had VA and Education talking, if there had been some kind of information system there—I don't know how many thousands of students have been taken to the cleaners in effect and not gotten an education because of this, but there are several hundred at least, maybe thousands. So it just seems to me that is one of the first things you need to do. It seems to me, before the week is over, Mr. Secretary, it ought to be possible for you to get with the Veterans' Administration and work out a memorandum of understanding that would immediately do it. I don't see how that would take a huge amount of time, even if it takes longer to make the system more sophisticated.

And as you get your database straightened out—you have just disqualified a number of schools here—the question occurs to me: do they know it?

Secretary **Cavazos**. They probably don't. And I appreciate the suggestion, and we will certainly move in that direction.

Senator **Nunn**. Well, that's good.

The other question on accreditation, the National Association of Trade and Technical Schools stated when they testified—this was Mr. Robert Taylor—"The Subcommittee must understand that private accrediting bodies such as NATTS are concerned with institutional integrity as it affects educational quality"—and this is the part I wanted you to focus on—"the detection and prevention of felonious criminal fraud against the Federal student loan program are responsibilities of Federal and State law enforcement authorities, not private accrediting bodies."

Now, we know that there are very few law enforcement people out investigating educational institutions—every now and then they run across it. And I run into this over and over again. We have had hearing after hearing in the labor area where the basic responsible agency or its agents did not feel any responsibility for fraud investigation, but only responsibility for the administrative end.

Mr. Secretary, it is important, if this is going to be the attitude of the Association of Trade and Technical Schools—obviously, it is—for you all to understand that this accrediting group is not looking for fraud, and by implication, if they run right into it, they aren't going to say anything about it unless it comes under their rather limited definition.

Do you all understand that that is their definition of responsibility?

Mr. **Childers**. Well, Senator, it is true that the regulations do not require accrediting agencies to look for fraud; as a matter of fact, it doesn't even mention student loan defaults in the kinds of things they are supposed to look at. And one of the things we are doing this year is taking a new look at the entire regulations governing the recognition process.

But it is true that those criteria are not mentioned in the regulations governing accrediting agencies.

Secretary **Cavazos**. I think you could gather here that as we strengthen that accrediting process, we're going to expect them to do that. Now, it is going to take some time, but we will look in that direction, too.

Senator **Nunn**. I think you need to look at that. It is one thing to say someone is primarily responsible. I know accrediting agencies don't want to be and probably wouldn't be qualified to be turned into criminal-type investigators. But it is another thing altogether to basically turn your head and ignore it and act like, even when you run into it, that you're not going to do anything about it.

There ought to be some mechanism and responsibility for them when they run into something that looks like fraud or smells like fraud to be able to report it and kick in the kind of investigative and law enforcement authority that is needed. In some of these cases, you are just basically dealing with criminals.

Mr. **Childers**. I agree. Internally, when program reviewers, who are typically not trained in criminal investigations either, run across something they think is a problem, we can refer that to our own Inspector General's Office, who have the people trained in that sort of activity.

Senator **Nunn**. OK, thank you.

In his February testimony, the Inspector General reported that over 41 percent of the $45 billion of outstanding student loans is administered by third party loan servicers. According to the Inspector General, review of these services are neither systematic nor consistent. One former Department employee testified that "we have been told by Education in Washington not to review servicers as we have no legal authority to do so."

Yet, as in the case of United Education and Software, which we went into, faulty loan servicing can ultimately cost the Department and taxpayers millions of dollars.

Now, the question is, Mr. Secretary, do you believe that third party loan servicers are being adequately monitored by the Department?

Mr. **Canellos**. Let me try to answer it this way, Senator. I think we have to start with the basic premise that the organizations that we contract with and have interface with legally are the guarantors and the lenders. We have responsibilities placed upon both of those to do certain things, and we audit those and we program review those to make sure that those are done.

Some lenders choose, because they don't have the capability, it is cheaper, or for whatever reason, to carry out some of their functions through a servicer.

Now, we have always taken the position, at least from what I have been able to ascertain, that if a servicer is working for one of the lenders that we are reviewing, that we are able through the lender to get access to the servicer and to verify that the servicer is in fact doing what they are supposed to for the lender; and if not, the lender is ultimately responsible. We hold the lender responsible because they are the ones who are obligated to us.

Now, to take a lender or a servicer out of the context of a particular lender and to review them specifically, I don't think we have ever done that. I know the UES problem was a FITCO-related one, and we looked at UES. But we certainly don't feel that we are limited in our abilities to go look at the servicers, and we look at them for the purposes of how they are complying with the requirements that they promised the lenders that they would carry out.

Senator **Nunn**. The Higher Education Act of 1965 as amended prohibits lenders from doing more than 50 percent of their commercial lending business in student loans. To your knowledge, Mr. Secretary or whoever is familiar with this on your team, did FITCO violate the Act from 1984 to 1986 until the law was changed in 1986?

Mr. **Canellos**. Not to our direct knowledge. We have certainly heard that.

Senator **Nunn**. Was the Department aware that this was happening?

Mr. **Canellos**. Well, again, I wasn't there at the time, but certainly there is more than enough audit trail to indicate that there was at least a question about that.

Senator **Nunn**. Does the Department feel that it is your job to monitor that, or is that up to the FDIC and others?

Mr. **Canellos**. Well, of course, that is a limitation that is placed on for banking purposes as well as protecting the program. We do monitor that on our reviews, but we don't have a computer-based or early warning type thing on that.

Senator NUNN. The California Banking Department testified that when they raised this, and FITCO's status as a trust company and its potential problems, the Department of Education's position was that FITCO was an eligible participant. In the case of the Bank of Horton, a Department reviewer found a violation, a finding which the Department in Washington subsequently overruled. Later, the FDIC issued a cease and desist against the bank, saying the bank's large volume of student loans violated Federal law.

I just wonder if this is a problem that goes beyond these instances and whether the Department itself has responsibility, or whether this is strictly a banking matter.

Mr. CANELLOS. Well, obviously, we have an interest, and I just checked and found out that there was some evidence that a reviewer had indicated that the FITCO operation was in conformance with the law, but that was never concurred in by the Department. We certainly don't think they were, and obviously they weren't.

Senator NUNN. In the case of FITCO, someone in the Department was aware as early as 1985 that origination fees were not being paid in a timely manner; but not until 1988 did the Department actively pursue these payments.

Have you looked at that track record, and could you tell us why it took 3 years for the Department to take action on collecting this money?

Mr. CANELLOS. Again, in reviewing the records on this, we basically have two not separate cases, but two distinct actions taken in the FITCO situation. It is an anomalous situation in that the normal practice on recovering back origination fees is to offset those off the interest and special allowances that are payable to the lending institution. That is required by statutory scheme, and it is applied by our regulations so that the same form that requests the repayment of special allowances and interest also offers up as an offset the origination fees.

FITCO as one of the rare cases—I am told one in 1,000—did not generate sufficient interest income or special allowance income because their process was to immediately sell their loans to the secondary market, and therefore they never had interest that was due them.

The situation at the time was that the Department really believed, or the opinion at the time was that they couldn't collect these origination fees because they had to wait to offset them against interest payments. Well, that subsequently was determined to be an erroneous interpretation, and we went out and we collected back the origination fees from the earlier years.

Then subsequently, FITCO began making their origination payments, and then because of finances or whatever—I think finances is the best account—they stopped making them. It was only after about a year or so that, based on program reviews, it was determined that they had run up a substantial sum of origination fees that they had not forwarded.

The Department now has a process in the computer system, inadequate as it is, where we know if that hasn't happened over four quarters, and then we take action by decertifying the lending institution. At that time, that wasn't the practice.

Senator **Nunn**. They built up a pretty large debt before anything was done.

Mr. **Canellos**. Yes, sir.

Senator **Nunn**. And you are saying that wouldn't happen again now?

Mr. **Canellos**. Well, it wouldn't happen past the fourth quarter. I am looking into why it should take four quarters. I have been told that there are many lenders that are small that just from the administrative burden of it don't submit their interest requests for one or two quarters and wait for three or four. But I am looking into making that a little more current a tickle system.

Senator **Nunn**. Well, it seems to me that no business would operate by letting their own money stay outstanding that long; I mean, nobody would operate like that.

Mr. **Canellos**. I would tend to agree, yes.

Senator **Nunn**. And I think with the condition of the Federal Government today, or any other time, but particular today, that that should not be tolerated. I am sure they are collecting interest on that money.

Mr. **Canellos**. Well, the interesting thing is I think the Department's original opinion was that, well, if the bank doesn't request their interest payments, they are not getting interest on interest, so it is their loss and not the Department's because the Department is just basically holding the money.

Of course, that never accounted for the fact that there would be an offsetting origination fee which was substantially higher than the interest that was due. In the normal case, if a bank is owed $1,000 in interest and they don't submit their voucher for that payment, we just don't pay it until they do, and they're out the use of that money for whatever period of time——

Senator **Nunn**. So you're saying that they offset each other in some cases.

Mr. **Canellos**. Yes, sir.

Senator **Nunn**. The president of HEAF, the Higher Education Assistance Foundation, Garry Hays, testified that when HEAF tried to terminate FITCO from participation in the student loan program, the Department of Education basically would not let that happen. As a result, HEAF estimates $500 million poured into FITCO even after the Department had been notified that FITCO, based on its high default rate, should have been terminated.

The question is why did the Department let this happen. Were you precluded by law from taking steps?

Mr. **Canellos**. Well, again in retrospect looking at it, it appears that HEAF was attempting to terminate the bank without any regulatory authority. They had no practice or policy established under which they would take this action; it was almost ad hoc. And if I could paraphrase it, I think the Department's position was you just cannot do it that way. You have to have an established procedure under which you terminate one of these lending institutions. I think maybe that's the answer to the question.

Mr. **Stringer**. Mr. Chairman, if I could add a note to that, when HEAF brought this problem to the attention of the Department, we explained that they had to go through the due process system. We also said that they could withdraw from California and terminate the FITCO loan guarantee business by that route, and they elected not to do that.

So HEAF stayed in the game in California and stayed with FITCO at their own option.

Senator **Nunn**. If that came back up today under your management, what would you do today? If HEAF came to you and told you the same thing about FITCO today, what would happen?

Mr. **Canellos**. Obviously, from what we know of FITCO, we certainly could take action ourselves, based on their fraud and take LS&T action and all that. Certainly, HEAF—I don't know if they have established their regulations yet, but certainly now that they are going out of business, I doubt that they did—I'm not familiar with that—but certainly, I think it was an action that was capable of being taken if the right information was brought forward.

Senator **Nunn**. I guess what I'm asking is if this happened in another FITCO-like operation and another HEAF, would you take the same steps today that were taken in this situation to let them continue in business?

Mr. **Canellos**. Well, I think we'd have to say if the guarantee agency that attempted to take action took it on an ad hoc basis without a regulatory scheme, certainly we would have to make the same response.

We do have a practice which is called disqualification which allows the Department to take an action if properly taken by the guarantor agency and apply it throughout the entire universe of guarantor agencies throughout the country. But we are required by the due process regulations to assure that due process was shown at the time. So it is a corollary of due process at both levels, and if we find that if, for whatever reason, no due process was applied at the initiation level, then our answer would be, well, we can't support that kind of action, and it can't be taken that way.

Senator **Nunn**. Well, if we've got guarantee agencies out here that are trying to raise the red flag and say they've got a real problem with a lender, and yet the Department of Education, by its own regulation or by law, is so wrapped up they can't do anything about it, we're really saying that this can happen again and again and again.

Maybe you'd better look at your regulations. Maybe you'd better get Mr. Stringer and his counsel to see if they can't find some way to react to these alarm bells.

I think the public is due some due process here, too. The public is taking huge losses on this. This is a small S&L situation. We've got big losses.

Mr. **Canellos**. Well, Senator, I think one of the Department's suggestions was that the Congress look at the due process setup of this entire spectrum of cases. In my looking at it as a former judge, they are inconsistent with one another. They talk of certain procedures in one aspect, certain procedures in another. And yet, when a practitioner tries to implement all the procedures that are laid out, it invariably drives them toward administrative quagmire. And the Department has recognized that, and we have made a suggestion—and I don't know how far that has gotten; I've certainly made the suggestion—that we need to commonize our practice. We've got to give the authority down to where it is required, and we've got to stop putting in all these roadblocks by creating practices and procedures that really are just self-defeating.

Senator NUNN. I agree with you completely. You have made that recommendation? Where is it? Is it working its way to the Secretary, or where is it? Has it gotten to the Congress?

Mr. STRINGER. It is in the reconciliation package.

Senator NUNN. That's part of your recommendations to Congress; so the Secretary has approved that?

Mr. STRINGER. Yes, sir.

Senator NUNN. We have seen several situations that suggested conflict of interest during the course of our investigation. The UES was processing loans backed by FITCO for students of UES-owned schools. In other words, they were both the owner of schools and they were the processors, collectors and so forth for FITCO. UES was also acting as loan servicer on these loans.

According to UES officials, Department representatives told them this was permitted. So what we have here—and maybe this is OK, but I think you ought to focus on it a little bit and take it under advisement; it seems to me it is questionable—school owners sit as members of State licensing boards and have jurisdiction over their schools. School owners sit on the boards of accrediting agencies that carry accreditation for their schools. Consultants offer to get a school accredited in exchange for a percentage of the Title IV funds that as a result will go to the school.

Are these types of things to be discouraged, or are they acceptable?

Secretary CAVAZOS. I don't think they are acceptable at all, and part of the problem is tracking those down and making sure that doesn't happen. But I agree with you, it just doesn't fit.

Senator NUNN. They say that that is permitted by the current rules, regulations and laws. I don't know where you draw the line, but it seems to me that we ought to have a clear line here somewhere. I don't have the details, but you're going to need some legal and policy input on that.

Mr. CANELLOS. Yes, I agree with you, Senator. But I don't think there is any prohibition—now, that doesn't mean there shouldn't be, and we're certainly going to look at that. Certainly, the conflict of interest interferes with the normal guardianship that we give to certain operations, and it certainly makes actions questionable. We'll look into that.

Senator NUNN. I won't go through all this about the Culinary School of Washington. We have heard a lot of testimony on that, and the operators and owners of that school testified last week and exercised their Constitutional right to not testify on the grounds of self-incrimination, so we didn't get much out of them.

But is there, Mr. Secretary, a procedure for civil action by the Department of Education to recover on behalf of the taxpayers and the students—I'll separate those 2 questions—number one, the taxpayers, number 2, the students—from people who have basically defrauded both the taxpayers and the students? Do you have civil authority, and if not, are you seeking that authority?

Mr. **Stringer**. Senator, we do not have authority to bring civil litigation on behalf of the students, but we certainly do on behalf of the Department, to recover civil fines, to bring actions to terminate in the traditional court sense.

Senator **Nunn**. How about recovery of funds the taxpayers have lost? Let's say the taxpayers lose—I don't know how much—let's say hypothetically $10 million in this Culinary School case. Do you have the authority to look behind the school itself and to go after the principals in a civil suit to try to recover some or part of this money?

Mr. **Stringer**. It would depend upon the specific case, but——

Senator **Nunn**. Let's take the Culinary School case.

Mr. **Stringer**. Yes, we certainly have taken that action against individual owners and officers of corporations that have engaged in fraudulent conduct.

Senator **Nunn**. So you have that authority on behalf of the taxpayers.

Mr. **Stringer**. Yes, we have.

Senator **Nunn**. Could you look at that set of statutes and see if you need any broader authority and let us know?

Mr. **Stringer**. We'll do that.

Senator **Nunn**. Would you also take a look both legally and policy-wise at whether the Department has now or should you be given—you said you do not—the authority to sue on behalf of students who have also been defrauded?

Mr. **Stringer**. We'll look into that.

Senator **Nunn**. It seems to me that somebody has got to step in here and take the interest of students. A student goes out, trying to get a skill, borrows the money from the Federal Government, goes in and gets no education at all, gets basically ripped off in terms of education, and then finds that they are being sued, their credit rating is ruined, they can't get anything going because of a loan hanging over their head, which they can't pay because they didn't learn the skill, and yet they are wrecked in some cases for life.

With the Federal Government having been involved in this from the beginning, shouldn't somebody be in a position of suing those who have defrauded this student on behalf of the student or a class of students? That's the legal question and the policy question, if you all could let us know—I'm sure you will let your committees of jurisdiction know, too, but we would also like to know, Mr. Secretary.

Secretary **Cavazos**. All right, Mr. Chairman.

Senator **Nunn**. I think we've got to pay some attention to the students here. I really think that they are often overlooked all the way around in this situation.

Mr. Secretary, is there any reason why we should not require guarantee agencies to submit delinquent loans to Internal Revenue Service for offset and skip tracing before submitting the loan to the Department of Education for reinsurance claim?

Secretary **Cavazos**. I don't see any reason why we shouldn't do that, Senator.

Senator **Nunn**. Is that an area you could take a look at?

Secretary **Cavazos**. Yes, sir, we will.

Senator **Nunn**. Senator Exon, we are delighted to have you join us today. Would you like to ask a question or make any comment?

Senator **Exon**. Just one brief question, Mr. Chairman, and thank you for inviting me to take part in this hearing. I am not on this Committee, but this is something that I am very much concerned about.

I am delighted that you are here, Mr. Secretary, with your staff.

Just let me say that the last few remarks Senator Nunn made express my position on this. All too often we overlook the students. There probably has not been a program that has done more good for more people, or for education as a whole, than the student loan program.

But now, having said that, you know and I know that there are disgraceful circumstances going on today. And when I look at these charts and see that the proprietary schools on that chart were 5 percent of the schools, causing over half of the defaults, something has to be done, or this whole program that has benefitted so many students, and so many students have paid back that money very faithfully, and unless we can get this straightened out, I am fearful that we are going to have an uprising in the Congress, and maybe this whole program could be devastated, which we just can't stand in America for the overall good primarily of our students in the future and primarily for the great institutions.

You are always going to have a default rate, and if the default rate were down in the 7 percent area, where I assume many of us thought it would be originally—have we taken any wholesale actions to just eliminate any of these schools, particularly the proprietary schools and others who have had gross default rates, so gross that it is almost a clearcut case of some type of collusion going on to rob the taxpayers?

Have you had a significant number of schools or institutions affiliated there with on these loan programs where you have just said no more; we won't make any more loans to students who attend this institution?

Secretary **Cavazos**. Yes, sir. We just last week put that one out, where we now have the authority to just take them right off the list. We had 14 taken off, and we anticipate we'll have many more that will not be permitted to have student loans.

I want to follow up on another point that you made and also the Chairman made, and sometimes we lose sight of it, all of us do. That is that there is a student, and that is really the basis of what is out there. That is why we have these systems, and that is why I have repeatedly during this testimony today, and you are also going to see it in the Higher Education Act reauthorization—if that student goes to a poor quality school, you might as well just forget about it. And I think we have made a mistake in the past that we have not concentrated on making sure that every one of those institutions were of quality for the kind of program that they are providing. And secondly, we have not held those institutions accountable for their action in totality.

So therefore I really believe that rather than saying we are going to remove all the proprietary schools or other schools, that we have to look to making sure that we get rid of the bad schools, so to speak, and then retain the good ones. And in so doing, then, we will be able to provide a quality education for a student regardless of whether they are going to Harvard or they are going to a proprietary school or a vocational-technical school.

So I'd like to say here for the record—and this is first of all going to sound rather odd in the face of the many comments the Subcommittee, and rightly so, has made about where we have failed many times as a Department—but I honestly believe that during our watch, we have really addressed the issue, but we are a long way from solving it, sir. But we must have the help of the Congress in doing this.

I'll go back out there, and I'll get after the regulation writers, and we'll take all the issues that have been discussed here and take them under review.

You see, when you get through it all, we all have the same purpose, and that is to educate the student and to prohibit the fraud and waste and abuse that we face.

Senator **Exon**. How many of those 135 schools that according to that chart represent only 5 percent of the total schools but over half of the default rate, how many of those schools have been knocked off as eligible for loans?

Mr. **Childers**. Senator Exon, starting this summer, we have been making a special effort to focus on high default rate/high default volume schools. Our first cut was to take any school that had over a 20 percent default rate and a default amount of more than $1.5 million in 1988. That amounted to 89 schools, which accounted for 30 percent of all the defaults in the 1988 cohort.

Senator **Exon**. How many?

Mr. **Childers**. Eighty-nine schools accounted for 30 percent of all the defaults in the 1988 cohort. We have focused on those 89 schools since the beginning of the summer. Some had closed since 1988. They had lost their accreditation, or they had gone bankrupt. Several more have closed this summer, just when they heard that the program reviewers were coming out to look at them. They have just closed within the last month or so. And we will continue to do that, and then when we have looked at those 89, we will take the next group of 89 or 60 or whatever it is, and just keep working down the list. But we are trying to focus our efforts very specifically on the schools of high default rate and high default volume.

Senator **Exon**. How many schools has the Department closed as opposed to schools that have closed for whatever reason since the statistics behind that chart came out? Have you closed one school, or 10, or 20 or 30—or, not closed the school—have you eliminated that institution from participating in the program? How many of those schools that are in trouble have been eliminated by your direct action as a Department?

Secretary **Cavazos**. Last week I eliminated 14 of them.

Senator **Exon**. Fourteen.

Mr. **Canellos**. We took emergency action on 14 schools. We've got to firm up the regulatory action. That's part of the process that I was telling Senator Nunn. It doesn't accomplish anything to just take the emergency action because the statute requires that we follow up with a normal process within 30 days and then follow through that, which could take a year or a year and a half. But in the 89, of the 14 schools, I think one or two were ones we took emergency action on. Now, the emergency action is by definition reserved for those cases where you find aggravating wrongdoing, and it has to be something more than just the high default rate.

Senator EXON. I might take issue with you on that. If you have a school with a high default rate, it would seem to me that there should be more emphasis paid to that as to whether or not they should be continued the courtesy of having their students make loans in the future.

I'd just like to see you get a little tougher on them.

Mr. CANELLOS. Well, there is a default initiative that we have regulated which does categorize schools by the default rate and does take them out of the program without cause, basically, just on the default rate. But that is a regulatory scheme that is implementable in a 2- or 3-year term, based on giving these schools the opportunity to reduce their default rate and so on. It was published 6 months ago—in June—and certainly we are looking to that, and we have the vehicle, but it is not fully implemented yet.

Senator EXON. OK, let me ask you this question. Let me simplify the question once again so I can get an answer to it. How many schools in the last 3 months or 6 months—take whatever you want—have been notified that no longer will their students be eligible for student aid?

Mr. CANELLOS. Well, there is a two-step process that I think——

Senator EXON. I'm not interested in the process. Isn't there a simple answer as to how many? Have you not told any schools "No more loans to any students who attend this school"?

Mr. CANELLOS. We've told 14 schools from an adversary point of view, from an adverse action point of view, that they are terminated.

The reason I hesitated was there are schools that are being taken out through the accreditation process, which is another process within the Department.

But from the adverse action point of view, we have taken 14 actions on an immediate basis; we have also taken 58 actions through the normal termination procedure. So I would say 72 during this year.

Senator EXON. Thank you.

Thank you, Mr. Chairman.

Senator NUNN. Thank you, Senator Exon. You may be interested in this. We talked earlier about a guarantee agency called Nebraska II, and I understand it is a State agency; is that right?

Mr. CANELLOS. Yes.

Senator NUNN. But it has reached out to other States, and it basically has about a 90 percent portfolio of proprietary schools, as we understand it. I understand their total portfolio of loans is about three-quarters of a billion dollars, about $750 million.

But we were told that the default rate is 2.9 percent for 1989. We have just been given information, and we'll ask you to check it out—this is telephone information—that their cumulative default rate is 29.5 percent since they went into business, instead of 2.9. So there may be a decimal point off here.

Senator EXON. It's a pretty big decimal point. Mr. Chairman, just let me say I don't care whether they are in Nebraska or where they are. It is time to get tough if we see people taking advantage of the system—we see this all the time in a whole series of areas——

Senator NUNN. We were talking about this before you arrived. I didn't pull this one out for you. I understand their default rate this year is 45 percent.

Mr. CANELLOS. Senator, we'd have to verify that.

Senator NUNN. That's telephone information——

Secretary CAVAZOS. Whom did they talk to, Mr. Chairman?

Senator NUNN. And of course, they are in the 100 percent honeymoon period, so like HEAF, they are not in a situation where they don't get reimbursed, but the taxpayers are taking a real big hit here if this is accurate information. Perhaps you all could check it out and get back. But there are all sorts of caution lights if not red lights on this one.

Senator EXON. It should be checked into very thoroughly even if it is in Nebraska.

Senator NUNN. We talked directly to the agency, Nebraska II.

Secretary CAVAZOS. That's the agency calculation of their default?

Senator NUNN. That's what we've got. I add it is by telephone, now, so it could be subject to review and may not be absolutely accurate. But I think it is an alarm bell.

Of course, the percentage of investment in proprietary loans is also an alarm bell, and there has got to be something done on that because there is a huge incentive here for a guarantee agency to get into these proprietary loans and do them in volume because they get the up front fees, they build up their reserves and all that. And it is an illusion, but that is the incentive for them to go out and canvass other States.

Senator EXON. I would say, Mr. Chairman, that the remarks that you have just made are very important because many of the things you have just said are what caused the mess in the S&L business when we didn't move rapidly enough.

Senator NUNN. That's right.

So Mr. Secretary and all of your team, I appreciate very much your being here. Do you have anything else you'd like to close with this morning?

Secretary CAVAZOS. Thank you, Mr. Chairman.

I really want to assure you I don't look forward to these kinds of sessions. I deeply appreciate what you and your Subcommittee have been doing in these areas. We know that there are a lot of things that need to be done, and we will take responsibility for our problems, and during my watch, we will try to straighten them out, and I think we have already made a lot of progress.

In the same way, I want to reiterate for the record that we need the support of Congress to give us the opportunity to be able to make some of the changes that we are going to ask for.

Senator NUNN. I can assure you that you will get my support, and I believe a number of members of this Subcommittee. And Senator Kennedy has indicated his support, which is a very big help on this; he's got a very powerful voice in this whole area. So I would hope you will make some progress. And even though we are not a Committee of jurisdiction and do not originate legislation, I can assure you we will continue our interest and will be working with the legislative committees over here, Senator Kennedy's committee, Senator Hatch, whose staff has been following this very closely, and I have talked to Senator Hatch about it, also. So we will be working with them. I will have a series of recommendations.

It would be helpful for us to have your recommendations or anything that you come up with subsequent to this hearing, so we can be kept current.

Secretary CAVAZOS. We will provide that, Mr. Chairman. And again, I want to thank you and all the members of your Subcommittee for the leadership that you have shown in these areas. It is an enormous problem, but we have to face up to it.

Senator NUNN. Well, we've all got to work together on it.

Secretary CAVAZOS. We will.

Senator NUNN. The ox is in the ditch, and we've got to get it going again and get it straightened out. It is important for the students, it is important for the taxpayers, and it is really in the long run important for our economy and our productivity.

Secretary CAVAZOS. I agree.

Senator NUNN. These skills that these students are seeking, to me is probably the most efficient part of our whole educational system, even more so than some of the other programs. I think giving skill training a lot of emphasis and also giving it some prestige and giving the students who are seeking these skills the kind of help they need and then, once they get into the skills, giving them a sense of prestige and accomplishment I think is one of the fundamental challenges we face in our economy.

Secretary CAVAZOS. I agree.

Senator NUNN. We've got to turn the situation around in terms of education and skill training.

So we look forward to working with you on this, and we thank all of you for being here this morning.

Thank you.

Secretary CAVAZOS. Thank you, Mr. Chairman.

Senator NUNN. We will be submitting questions for the record. [See Exhibit No. 6.]

Secretary CAVAZOS. All right, sir.

[Whereupon, at 12:35 p.m., the Subcommittee was adjourned.]

APPENDIX

DEPARTMENT OF EDUCATION

Statement of

Lauro F. Cavazos

Secretary of Education

Before the

Permanent Subcommittee on Investigations

Senate Committee on Governmental Affairs

October 10, 1990

Mr. Chairman and Members of the Subcommittee, I come before you today to join hands with you in our mutual efforts to reform the Guaranteed student loan programs. The work your subcommittee has done and the hearings you are holding are focusing the Nation's attention on a series of abuses, flaws in the statute, and long-standing management deficiencies that deserve to be brought out into the light of day. Since I became Secretary, I have become increasingly aware of these problems and, as I will outline later, I have taken a number of steps to address them. But much more remains to be done. The work of this Subcommittee will help us and the Congressional authorizing committees to accomplish this task.

While you have been conducting these Subcommittee hearings, we have also been through a very revealing and trying time, set off by the financial instability of a major guarantor, the higher Education Assistance Foundation. I will explain the details of how we resolved that situation in a few moments. The more important point, however, is that the HEAF's situation, and the crisis atmosphere in which we had to resolve it, were caused by the same problems you are worrying over; inadequate legislative authority for the Secretary to establish meaningful program controls and to get rid of wrong-doers, inadequate Federal oversight for many years, and inadequate performance by accrediting agencies, guarantors, schools and lenders. There is plenty of blame for everyone.

However, my goals and yours, I am sure, is not to dwell on the blame but on the cures. Today I want to outline for you the management actions we are taking, and the legislative proposals we have made for immediate action. The Administration is also developing its proposals for reauthorization. I can personally assure you, we will directly address significant reform of the loan programs.

Since their beginning, the student financial assistance programs have played an important role in ensuring access to postsecondary education, especially for our most needy students. In fact, in fiscal year 1990, over three million students received help in meeting the cost of their postsecondary education through the Pell grant program. In addition, over four million loans were provided to student borrowers. We all accept that a loan program, designed for students who may have no credit history, will result in some defaults. That is a price we are willing to pay for the benefits we gain.

But the testimony presented to this Subcommittee tells of staggering default rates, program abuses, and unscrupulous business practices at the expense of unsuspecting students. And I believe many of these stories are true. They make clear the immediate threat to the viability and integrity of our programs, and to the future of hundreds of thousands of young Americans who deserve a quality education. Students must not only have access to a classroom seat. They must be assured of a sound education, that will benefit their lives as they become productive and educated citizens, and that will secure the Nation's future. We, as lawmakers, executors and trustees of the student aid programs, have a solemn responsibility to the students of this Nation. Unless we are able to ensure the integrity of the education we are helping to finance, the American promise of educational opportunity and success will ring hollow.

Achieving quality education and stopping program abuses require a strong partnership among the Department of Education, accrediting agencies, State licensure bodies, guarantee agencies, lenders, and schools. By instituting significant improvements in the student loan system and providing appropriate performance measures to ensure accountability, we can reach these important goals.

As Secretary of Education, one of my primary goals has been to take every action possible within the Department's authority to ensure quality at the postsecondary level and effective oversight of our programs. That is why, in my first week as Secretary, I withdrew proposed default reduction regulations, solicited extensive public comment on the default problem, and directed a comprehensive review and restructuring of the proposed regulations. We weighed the merits of more than 3,000 comments, and I issued final regulations on June 5, 1989.

These new requirements include: delayed disbursement of loan proceeds to first time borrowers, the use of pro rata refund policies, and suspension of extremely high default schools. This was the most extensive revision directed to student loan defaults in the history of the Department.

By requiring participating schools to take concrete steps to improve the administration of the student aid programs, our new regulations will inevitably have a positive impact and reduce student loan defaults. They are tough, but fair-minded. They go as far as we felt we could go under the law at the time. They are working, but they are not enough. We need more statutory authority.

Well over a year ago, I submitted to Congress the second component of the Student Loan Default Reduction Initiative, the "Student Loan Default Reduction Amendments of 1989." This bill would improve entrance standards for students admitted under the "ability to benefit" provision, prohibit commissioned recruiters, require lenders to offer graduated repayment options to borrowers, allow guarantee agencies to garnish defaulter's wages, require lender credit checks of potential student borrowers, expand our pro rata refund policies, grant emergency action authority, and prohibit "accreditation shopping" for schools that lose their eligibility. These proposals are well conceived, and few people doubt their necessity. But to date, only the last three of these eight provisions have been enacted into law by Congress, with the pro rata refund provision only in effect for this fiscal year.

As part of the original budget agreement reached between the President and Congressional negotiators, the authorizing committees will likely be instructed to achieve a $2 billion savings over five years in the Guaranteed Student Loan programs. We have suggested a set of proposals to Congress that will not only meet these budgetary goals, but implement key default reduction measures, and provide important new authority for the Department. They include:

-- Strengthening Departmental authority to oversee guarantee agencies;
-- Delaying disbursement of loans for 30 days;
-- Barring commissions for recruiters;
-- Requiring credit checks for borrowers over age 21;
-- Requiring graduated repayment options;
-- Authorizing guarantee agency and Department of Education wage garnishment;
-- Requiring pro-rata refunds;

-- Amending the bankruptcy law to preclude participation in student aid programs, accreditation, and State licensure from being protected as "property";
-- Extending the prohibition against Supplemental Loans for Students for students at high-default schools;
-- Eliminating Title IV eligibility, with opportunity for limited appeals, for schools with default rates over 40 percent for the first year, 30 percent for the second year, and 25 percent for future years; and
-- Restricting eligibility for correspondence schools.

Again, I urge quick Congressional action to provide the Department these needed tools for eliminating program abuses and reducing defaults.

There are several other administrative and regulatory actions we have taken to reduce loan defaults and stem the tide of program abuse.

As you may be aware, the Department manages the defaulted student loan collection process, and has achieved impressive results. In fiscal year 1990, $261 million was collected through IRS offset. Over $100 million was collected by the Department or private sector collection contractors. $349 million was collected by guarantee agencies and forwarded to the Department. Another $12.2 million was collected by the Department of Justice. The

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Department is taking numerous administrative actions to further improve the efficiency of these collections.

To improve our determinations of compliance with student aid regulations, we have dramatically increased the number of on-site reviews of postsecondary institutions from 372 in FY 1987 to over 1,200 in FY 1990. We have also increased the number of lender and guarantee agency reviews from 232 in FY 1987 to 554 in FY 1990.

The Department is assigning program review teams to undertake comprehensive and regular reviews of all guarantee agencies. The first cycle of reviews covers 14 of the 54 guarantee agencies. The Department has also engaged the services of a financial management firm to provide support to the program review teams in analyzing the financial condition of each agency. Following the first cycle of reviews, the Department will complete successive cycles of reviews for the remaining guarantee agencies. We plan to monitor the guarantee agencies closely and to continue the reviews on a routine, periodic basis.

The Department is also now working to publish regulations to stop other program abuses. We have found that many schools have been using highly questionable clock hour/credit hour conversions. As our Inspector General told you, we know about a school where a 13 month, 1,300 clock hour x-ray technician program was reported as converted to 78 credit hours. An actual change in course work did not take place, but the conversion increased the amount of aid for which students were eligible from $8,500 to nearly $18,000. Conversions like this allow institutions to circumvent the minimum course length requirements, and dramatically increase the amount of student aid funds they receive for the same course.

On October 1, we published a proposed regulation, that applies an existing and well known standard -- the "academic year" -- to all courses. This regulation would impose uniformity when measuring course length, and provide needed comparability between clock hours and credit hours.

The Department is also acting to stop schools from circumventing the "two year" rule, which requires an institution to be in existence two years before it may participate in our student aid programs. We are preparing a proposed regulation that will, when final, make both new branches of eligible schools and new free-standing schools wait two years before receiving Title IV funds. By requiring both new and former branch campuses to operate for two years, independent of the Federal programs and funds, I believe these abuses of the two-year rule will be curtailed.

Additionally, beginning in August, the Department no longer automatically certifies new branch campuses. Instead, a request to certify a new branch triggers a reexamination of the entire institution.

It is becoming increasingly clear that many accrediting agencies are not doing the job we have entrusted to them. Before a school may participate in the Federal student aid programs, it must be accredited by an agency recognized by the Secretary. The National Advisory Committee on Accreditation and Institutional Eligibility is responsible for advising me about recognizing the agencies that petition for recognition. The Advisory Committee needs to improve greatly the quality of its advice.

I have directed the National Advisory Committee to target those agencies that accredit schools with excessive default rates. For example, on September 10, 1990, I released the names of 89 schools which accounted for more than 30% of all defaulted loans in the 1988 cohort. These 89 schools, some of which have already shut down, represent less than 1% of the Nation's 10,000 postsecondary institutions, yet they account for $365 million of $1.2 billion that went into default among the FY 1988 cohort. Even more astounding, 84 of these 89 schools were accredited by only 7 of the Nation's 96 recognized agencies.

I am convinced that accrediting agencies must focus on educational effectiveness and must see to it that schools with high default rates are held accountable. We will continue to emphasize the examination of educational outcomes and institutional accountability.

Less than three weeks ago, the Department's emergency action regulations went into effect. These regulations make it possible for the Department to immediately suspend schools that are violating the law, hurting needy students, and costing the taxpayers millions. As you may know, last Thursday, I announced the immediate suspension of student financial aid to 14 for-profit trade schools, based on this new authority. I have promised the Congress and the American people that we will protect the integrity of the Federal student aid programs. We are now mobilizing and launching our attack on still more unscrupulous school owners. We plan to continue aggressive monitoring of all schools, and I will not hesitate to use this authority in the future.

A high priority for departmental action in recent weeks has been the successful resolution of the problems surrounding the financially troubled Higher Education Assistance Foundation (HEAF). HEAF has been one of the largest guarantee agencies in the Guaranteed Student Loan (GSL) programs. It serves as the designated guarantor for the States of Minnesota, Kansas, Wyoming, West Virginia, and Nebraska, and for the District of Columbia, and also guarantees loans in other jurisdictions.

When we learned of HEAF's problems at the end of June, we were profoundly concerned. A HEAF collapse could have endangered loans in the HEAF portfolio, student access in the HEAF-designated States, and lender participation in the GSL programs. A nationwide erosion of student and lender confidence in the programs could have also occurred.

On September 28, I announced an agreement in principle which has been signed between the Department of Education and the Student Loan Marketing Association, or Sallie Mae. Under the agreement:

-- HEAF will continue to exist for three years, but will make no new guarantees once the Department names interim guarantors in jurisdictions in which HEAF is currently the designated guarantor;
-- HEAF will enter into a management contract with a newly created Sallie Mae subsidiary providing for the servicing of HEAF's portfolio, and the transfer of HEAF guarantees to other guarantee agencies during this period;
-- A new HEAF board is being appointed by the Department and Sallie Mae;
-- Sallie Mae will arrange financing for HEAF's operations;
-- Neither Sallie Mae nor its new subsidiary, will serve as a guarantee agency;
-- The Department will closely monitor the agreement and the transfer of loan guarantees to other agencies. We must

ensure that such transfers are proper and fair, and do not cause financial problems for the other agencies or additional costs for taxpayers;

- I will be designating, for an interim period of up to one year, primary guarantors to handle new guarantees in the jurisdictions where HEAF had performed this function. During this period, we will be consulting with the chief executive officers of these jurisdictions to decide upon long-term designations; and
- Sallie Mae's compensation will depend on its performance in transferring the guarantees to other guarantors, increasing collections, and minimizing operating costs. Its total compensation may not exceed $20 million.

This solution meets the principles stated when we first assessed HEAF's financial condition:

- stabilize the GSL programs;
- assure students, their families, and schools of continued access to loans;
- avoid a recurrence of the problems causing HEAF's financial difficulties; and
- keep costs to the taxpayer to a minimum.

And finally, beginning in 1991, we have an historic opportunity to fundamentally reshape the future of Federal involvement in higher education through the reauthorization of the Higher

Education Act. The current structure for the student aid programs will have been in place for over twenty five years when the current authorization of the Higher Education Act expires. We are considering what changes need to be made in the system to help us meet the National Goals for Education, to enhance access for disadvantaged students, and to meet the economic and social needs of the 21st century.

This legislation will afford us the opportunity to demonstrate that thoughtful reasoning and careful deliberation can yield a student aid system that works to achieve our Nation's education goals. But now, we have the chance to accomplish more than just marginal repairs. We can accomplish the major restructuring the system needs. The Administration's proposals will be transmitted to Congress early in 1991.

The Department's reauthorization proposals will be based on the four themes of President Bush's education policy: 1) rewarding excellence and success in education by providing Federal incentives for education achievement; 2) targeting Federal dollars to help those most in need; 3) promoting choice for individuals and flexibility in existing program delivery systems; and 4) promoting greater accountability.

As you know, individual interests often exercise undue political influence on the development of national policy. That is one of the reasons we have seen a system develop that is convoluted and unworkable. I would cite the special exception granted by Congress on behalf of FITCO that allowed it to exceed the standard maximum loan volume as a ominous warning. I hope that Congress will commit with me to avoid these parochial interests during reauthorization.

Working together, we can enact a Higher Education Act that provides access to quality education for all Americans as we move into the 21st Century.

I appreciate the Subcommittee's interest in this important issue, and I would be pleased to answer any questions you may have at this time.

Appendix to Testimony of
Lauro F. Cavazos
Secretary, U.S. Department of Education

Before the
Permanent Subcommittee on Investigations
Senate Committee on Governmental Affairs
October 10, 1990

Since their beginning, Federal student financial assistance programs have played an important role in ensuring access to postsecondary education, especially for the Nation's most needy students.

The Department of Education (ED) has been given the responsibility to ensure that the student aid system works by establishing regulations that cannot be circumvented, monitoring schools and other program participants, and gathering and disseminating consumer information. The Department is responsible for administering the student loan programs and ensuring that other players in the program meet their responsibilities and effectively perform their functions.

Over the last two years, the Department has initiated several regulatory and administrative changes to improve its operation and oversight of these programs. In addition, ED has proposed important legislative reforms that would help the programs function well under their present design.

Default Reduction Initiative

On June 5, 1989, ED published final default reduction regulations that are designed to reduce student loan defaults by requiring participating schools to take concrete steps to improve the administration of the Guaranteed Student Loan (GSL) programs. The regulations target the worst offenders with the toughest possible sanction -- elimination from participation in the student aid programs. And those schools with a less severe default problem are accordingly given appropriate corrective steps that they must follow -- default management plans, pro-rata refunds, entrance and exit counseling to student borrowers, and delayed loan delivery to first-time borrowers, among others.

Schools offering certain types of vocational programs or schools that advertise their placement rates must also provide detailed consumer disclosures on completion, job placement, and state licensing pass rates to prospective students.

Finally, the regulations provide the Department with the authority to take steps to terminate a school from participation in all the student aid programs if the school does not take all steps necessary to reduce defaults.

On June 30, 1989, Secretary Cavazos submitted to Congress the "Student Loan Default Reduction Amendments of 1989" (S. 2029 -- Gramm (R-TX), Dole (R-KS), and H.R. 4124 -- Smith (R-OR)).

The Administration's plan would:

-- require students without a high school diploma or GED to pass a test, before enrollment, which is designed and administered by an independent third party;

-- prohibit the use of commissioned recruiters and admissions personnel in enrolling students;

-- require lenders to offer optional graduated loan repayment schedules to all student loan borrowers;

-- authorize guarantee agencies to garnish the wages of defaulters, up to 10 percent of disposable earnings;

-- require lenders to perform credit checks on all student loan applicants age 21 or over;

-- establish a pro rata refund requirement for all Federal student aid recipients at schools with default rates above 30 percent (enacted in P.L. 101-166, the Department's FY 1990 appropriations Act and effective for one year only);

-- give the Secretary emergency authority to suspend a school's or lender's participation in student aid programs (enacted in P.L. 101-239); and

-- prohibit recertification of schools for participation in the student aid programs for two years after they have lost their accreditation (enacted in P.L. 101-239).

Congress has enacted three of these proposals, as noted above. The Department urges Congress to make permanent those measures which have been passed as temporary measures, and to take action on all other provisi[illegible] proposed by the Department.

Audit and Inspection Reports

The Inspector General's (IG) office has increased its attention to the student aid programs, focusing two-thirds of its resources (200 staff members) in this area. The Inspector General has identified abuses in the student loan programs, recommended improvements, and worked with other Department of Education offices to implement corrective actions. Since October 1988, for example, the IG has issued 53 audit reports and five inspection reports concerning proprietary schools. Sixteen of these schools are now closed.

Defaulted Student Loan Collections

The Department of Education, in conjunction with the guarantee agencies, manages the defaulted student loan collection process, with staff in its headquarters office and three regional offices. Total collection receipts are projected to be over $722 million in fiscal year 1990, an increase of approximately $79 million over fiscal year 1989.

In fiscal year 1990, through September 30, $261 million was collected through IRS offset, over $100 million was collected by the Department or private sector collection contractors, and $349 million was collected by guarantee agencies and forwarded to the Department.

Over the past four years, Department of Education revenues from defaulted student loan collections, not including revenues from guarantors, have averaged over $300 million per year. Over the same period, reimbursements from guarantors resulting from their collection efforts on Guaranteed Student Loans averaged over $260 million per year.

The Department is taking the following administrative steps to increase collections:

-- Due Diligence Enforcement. The Department enforces "due diligence" regulations, published in 1986, which establish minimum lender and guarantee agency collection effort requirements.

-- Credit Bureau Reporting. The Department continues to report ED-held defaults to consumer credit bureaus in order to adversely affect a defaulter's ability to obtain credit financing until satisfactory repayment arrangements are made with the Department. The due diligence regulations also require lenders and guarantors to report debts.

-- Federal Employee Match. Since the Federal employee salary offset program was authorized in 1982, more than 60,000 Federal employees have been identified and sent notices to repay defaulted student loans. Cumulative collections resulting from the Federal salary offset program total over $32 million. Federal agencies have implemented screening procedures to prevent student loan defaulters from being hired without having entered into repayment agreements.

-- IRS Offsets. The offset of defaulters' Federal tax refunds has resulted in over $898.4 million in collections from fiscal year 1986 through fiscal year 1990 on approximately 1.6 million accounts.

- -- Referrals to Justice. ED continues to refer delinquent debt to the Justice Department for litigation. Cumulative collections on these accounts total an estimated $53 million, and as of July 30, 1990, 26,166 cases valued at just over $81 million had been referred for litigation. In fiscal year 1990, collections totaled $12.2 million.

- -- Private Collection Services. ED has increased the number of its contracts with private sector collection services to collect on ED-held defaulted loans. The number of new collection contracts were increased from six to 12 in April 1990.

- -- Permanent Assignment of Accounts from Guarantee Agencies. During fiscal year 1990, the Department continued assignment of accounts from guarantee agencies to ED for three purposes: (1) to offset the salaries of Federal employees who are defaulters, (2) to compare the guarantee agencies' collection performance with that of the Department's collectors, and (3) as of 1989, to collect on accounts which have passed or are within 6 months of the State statute of limitations, or are "skips" (i.e. defaulters who cannot be located) aged over five years.

- -- Assessment of Collection Costs. The Department requires student loan defaulters to pay costs associated with debt collection. Since 1987, defaulters have been assessed a fee related to the commissions charged by collection agencies under contract to the Department. The Department is beginning to pass on other administrative charges to defaulters.

Guarantee Agency Reviews

The Department is assigning program review teams to undertake comprehensive and regular reviews of all guarantee agencies. The first cycle of reviews covers 14 of the 54 guarantee agencies. The Department has also engaged the services of a financial management firm that is providing support to the program review teams in analyzing the financial condition of each agency. Following the first cycle of reviews, the Department will complete successive cycles of reviews for the remaining guarantee agencies. ED plans to monitor the guarantee agencies closely and continue the reviews on a routine, periodic basis.

Focus on High Default Schools

On September 10, 1990, the Department released the names of 89 institutions with default rates over 20% and defaulted student loans of $365 million. These 89 institutions - less than 1% of the Nation's 10,000 postsecondary institutions - accounted for more than 30 percent of the $1.2 billion in loans from the FY

1988 cohort that went into default. Of these 89 institutions, 84 were accredited by only seven of the 96 accrediting agencies recognized by the Department. About one-third of these schools are now closed due to actions initiated by the Department, actions by accrediting agencies, and other reasons, such as restrictions placed on Supplemental Loans for Students (SLS) in the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239).

The Department is:

-- conducting program reviews of these schools to determine their competence to administer student aid funds;

-- determining if these schools have sufficient financial resources to continue their activities; and

-- looking at school records held by their accrediting agencies to determine if the agencies have been aware of the problems of these schools and what, if any, corrective actions they have taken.

Accrediting Agency Effectiveness

As noted above, the majority of these schools are accredited by the following seven accrediting agencies:

-- The Accrediting Bureau of Health Education Schools (ABHES);
-- The Accrediting Council for Continuing Education and Training (ACCET);
-- The Association of Independent Colleges and Schools, Accrediting Commission (AICS);
-- The National Accrediting Commission of Cosmetology Arts and Sciences (NACCAS);
-- The National Association of Trade and Technical Schools, Accrediting Commission (NATTS);
-- The National Home Study Council, Accrediting Council (NHSC);
-- Southern Association of Colleges and Schools, Commission on Occupational Education Institutions (SACS).

Secretary Cavazos has directed the National Advisory Committee on Accreditation and Institutional Eligibility to expand its review of accrediting agency standards and activities, and specifically, to scrutinize these seven agencies.

ED's Undersecretary, Dr. Ted Sanders, and Assistant Secretary for Postsecondary Education, Dr. Leonard Haynes, recently met with representatives of the accrediting agencies and discussed the dimensions and gravity of the default problem. Dr. Sanders and Dr. Haynes told the agencies they must work to prevent bad schools from being accredited, and to revoke the accreditation of bad schools which are already accredited.

Emergency Actions

On September 21, 1990, the Department's emergency action regulations went into effect. These regulations, based on a provision of the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239), recognize the Secretary's authority, in cases of significant abuse of the student aid programs, to immediately suspend schools from the student aid programs, rather than wait for the completion of lengthy administrative processes. On October 4, the Department announced the immediate suspension of student financial aid to 14 for-profit trade schools, based on this new authority. The following schools were terminated:

CALIFORNIA:
-- Transwestern Institute, Long Beach
-- Metropolitan Business College, Long Beach

CONNECTICUT:
-- Hartford Modern School of Welding, Hartford

FLORIDA:
-- Cocoa Beach Beauty College, Cocoa Beach
-- Romar Hairstyling Academy, Kissimmee
-- Romar Melbourne Beauty Academy, Melbourne
-- Romar Beauty School, Melbourne
-- Romar Academy of Style Masters, Merritt Island
-- Romar Hairstyling Academy, Palm Bay
-- National Beauty Academy, Tampa
-- Titusville Beauty School, Titusville
-- Romar Hairstyling Academy, Winter Park

GEORGIA:
-- Balin Institute of Technology, Atlanta

WASHINGTON STATE:
-- Metropolitan Business College, Port Orchard.

Program Reviews, Terminations, and Fines

In order to improve the evaluation of compliance with student financial assistance regulations, the Department conducts on-site reviews of postsecondary institutions, guarantee agencies and lenders. The number of schools reviewed increased from 372 in FY 1987 to over 1,200 in FY 1990. The number of lender and guarantee agency reviews increased from 232 in FY 1987 to 554 in FY 1990.

In selecting schools for review, the Department focuses on schools likely to be having problems with program administration management. The criteria for review include:

- High cohort default rates and high defaulted loan volume;
- Rapidly increasing loan or grant volume;
- Failure to submit required biennial audits;
- Multiple branch locations;
- Financial problems; and,
- Student complaints.

ED has also increased the number of termination actions initiated against schools with serious violations of program requirements. In FY 1990, ED has acted against 64 schools compared with only 14 in FY 1987. In addition to termination actions, the Department has increased the number of fines assessed against institutions that violate program requirements from 81 in FY 1987 to 245 in FY 1990.

Regulatory Initiatives to Combat Abuse

The Department is also working to publish regulations to stop other program abuses. The Department found that the clock hour/credit hour conversions at many institutions were highly questionable. In almost all cases, unreasonable claims of outside preparation time were made, and after the conversions, student aid awards increased dramatically.

The Department of Education's Inspector General testified before the Subcommittee about a school where a 13 month, 1,300 clock hour x-ray technician program was reported as converted to 78 credit hours. An actual change in course work did not take place, but the conversion increased the amount of aid for which students were eligible from $8,500 to nearly $18,000.

This abuse has two major consequences. First, it allows institutions to circumvent the minimum course length requirements for their short courses. Secondly, institutions inflate the length of courses that already qualify for student aid and greatly increase the aid they receive for the courses, without increasing the actual amount of education given to the student.

The Department's proposed regulation, published on October 1, 1990, would impose more uniformity to the measurement of courses for which schools seek student aid funds by applying an existing and well known measure - the "academic year." An academic year is defined as at least 24 semester or trimester hours, 36 quarter hours, or 900 clock hours of instruction. Therefore, under the Department's proposal, a semester or trimester hour must provide at least 37.5 clock hours of instruction (900 clock hours divided by 24 semester or trimester hours), while a quarter hour must provide at least 25 clock hours of instruction (900 clock hours divided by 36 quarter hours).

Institutional Eligibility

Another area of major program responsibility is institutional eligibility. The Department has identified the following opportunities for strengthening and improving the process:

-- Admissions. Ensure that every student possesses a high school diploma or its equivalent, or meets a meaningful ability-to-benefit test;

-- State Legal Authorization. Work with State licensing agencies to develop mutual goals of improved oversight to improve institutional quality;

-- Accreditation. Improve the process for recognizing accrediting agencies to ensure a higher quality of instruction by accredited institutions;

-- Program of Instruction. Require, as a condition of recognition, that accrediting agencies verify that their schools' instructional programs are indeed postsecondary in nature, not simply short-term job training.

In addition, in 1989 ED reached an agreement with the Accrediting Commission of the National Home Study Council (NHSC), providing that NHSC will validate the length of correspondence courses offered by its accredited institutions. In cooperation with NHSC, the Department is now reviewing correspondence courses to verify the course length claimed by the institutions.

The Department is also preparing a proposed regulation that will make both new branches of eligible schools and new free-standing schools wait two years before receiving student aid funds. By requiring both new and former branch campuses to operate for two years, independent of Federal programs and funds, the Department will help to ensure that the schools are financially sound and administratively capable.

Despite this encouraging progress, there are areas of substantial abuse which remain almost impossible to solve under present law.

o Course stretching. As the number of proprietary schools has grown in recent years, adding unnecessary hours of instruction in order to quality for student aid has emerged as a major area of abuse. The Department is encouraging State agencies and accrediting agencies to look for evidence of course stretching, and take action to prevent it.

o Unnecessary training. ED continues to discover programs, in such areas as retail sales, that charge high tuition to train students for positions that pay at or only slightly above the minimum wage, and for which employers typically provide their own on-the-job training.

Certification

In certifying a school, ED reviews at least two years of financial statements, and information about persons administering student aid funds.

As of August 24, 1990, ED no longer automatically certifies new branches of currently eligible institutions for student aid funds. Instead, a request to certify a new branch triggers a reexamination of the entire institution to see if it has the financial resources and administrative capability to manage student aid funds at a new branch.

Recently, a new procedure has also been implemented which requires an institution to secure employee fidelity bonds and have representatives of the institution attend Department classes in financial aid administration before authorizing or disbursing any student aid.

During the past year, ED has increased the number of institutions that are required to post surety and the amount of surety. In general, ED now requires that all surety be in the form of an irrevocable letter of credit and will no longer accept a corporate bond or a pledge of assets.

Institutional Data System

The Office of Postsecondary Education's Institutional Data System (OPE-IDS) is designed to provide ready access to key information on postsecondary education institutions and lenders eligible for the various programs in the Higher Education Act. As more information is shared, the Department will be better equipped to take prompt and effective action against institutions misusing student aid funds.

National Student Loan Data System

The 1986 amendments to the Higher Education Act authorized the Department to establish a National Student Loan Data System which would include records from the Guaranteed Student Loan and Perkins Loan programs. However, a statutory proscription prevented the Department from using the system to determine an individual's eligibility for a loan. At the request of the Department, this prohibition was removed in the Omnibus Budget Reconciliation Act of 1989 (P.L. 101-239), permitting ED to use the system to ensure that prior defaulters and other ineligible applicants do not receive loans. The Department is in the final stages of developing the system concept.

State Effectiveness

States also have a key role to play in ensuring high quality postsecondary opportunities through their licensing, monitoring, and consumer protection.

More than two years ago, ED began to expand contacts with the State authorizing and licensing agencies, both individually and through the National Association of State Administrators and Supervisors of Private Schools (NASASPS). These contacts include: ED representatives appearing as speakers and panelists at NASASPS conventions; regular monthly telephone conferences with representatives from the State agencies; and opening the Department's Institutional Data System, in a read-only capacity, to the State agencies.

The Department is undertaking a study on how States currently assess student outcomes in postsecondary vocational programs. Preliminary findings suggest that State assessment of student outcomes tends to focus primarily on public institutions and that States do not collect uniform assessment information.

HEAF Settlement

On Friday, September 28, Secretary Cavazos announced a plan to resolve the problems surrounding the financially troubled Higher Education Assistance Foundation (HEAF).

HEAF has been one of the largest guarantee agencies in the Guaranteed Student Loan (GSL) programs. Based in St. Paul, Minnesota, HEAF serves as the designated guarantor for the States of Minnesota, Kansas, Wyoming, West Virginia, and Nebraska, and for the District of Columbia, and also guarantees loans in other jurisdictions.

At the end of June, HEAF informed the Department of its financial problems and of its anticipated inability to pay lenders' claims. This information raised the most profound concerns in our Department. A HEAF collapse could have endangered loans in the HEAF portfolio, student access in the HEAF-designated States, and lender participation in the GSL programs. A nationwide erosion of student and lender confidence in the programs could have also occurred.

Based on these concerns, the Department has given the highest priority to the resolution of this problem. An inter-office team, headed by our General Counsel, was established to develop and negotiate options, in conjunction with an independent financial advisor.

The Department's efforts included the following:

- A program monitoring team and auditors from our Office of Inspector General have made extensive on-site reviews of HEAF to ensure that the operational situation is stable and that assets and programs are not dissipated pending a resolution of the problem.

- The Department arranged for additional temporary financing by working with the Student Loan Marketing Association so that HEAF could meet its financial obligations through September 30. This reassured the financial community and the chief executive officers of the jurisdictions in which HEAF serves as the designated guarantor of our commitment to resolve the matter. Secretary Cavazos contacted the Governors of Minnesota, Kansas, Wyoming, and West Virginia, and the Mayor of the District of Columbia, and assisted them in reassuring their lending institutions. Accordingly, lenders have continued to make loans, and student access to loans has not been impaired in these jurisdictions.

- Finally, the Department is taking actions that address high default rates and program abuses that ultimately contributed to HEAF's financial problems.

Under that agreement in principle, which has been signed between the Department of Education and the Student Loan Marketing Association, or Sallie Mae:

- HEAF will continue to exist for three years, but will make no new guarantees once the Department names interim guarantors in States in which HEAF is currently the designated guarantor;

- HEAF will enter into a management contract with a newly created Sallie Mae subsidiary providing for the servicing of HEAF's portfolio, and the transfer of HEAF guarantees to other guarantee agencies during this period;

- A new HEAF board is being appointed by the Department and Sallie Mae;

- Sallie Mae will arrange financing for HEAF's operations;

- Neither Sallie Mae nor its new subsidiary, will serve as a guarantee agency;

- The Department will closely monitor the agreement and the transfer of loan guarantees to other agencies. We must ensure that such transfers are proper and fair, and do not cause financial problems for the other agencies or additional costs for taxpayers;

-- The Secretary will designate, for an interim period of up to one year, primary guarantors to handle new guarantees in the jurisdictions where HEAF had performed this function. During this period, ED will be consulting with the chief executive officers of these States to decide upon long-term designations; and

-- Sallie Mae's compensation will depend on its performance in transferring the guarantees to other guarantors, increasing collections, and minimizing operating costs. Its total compensation may not exceed $20 million.

The solution announced by the Department meets the principles stated by ED when it first learned of HEAF's financial condition: stabilize the GSL program; assure students, their families, and schools of continued access to loans; avoid a recurrence of the problems causing HEAF's financial difficulties; and keep costs to the taxpayer to a minimum.

Higher Education Act Reauthorization

For over a year, a special task force at the Department has been examining our student aid programs in preparation for the 1991 reauthorization of the Higher Education Act. The solutions being developed by the Department show great promise for the improving student aid programs. The Department looks forward to working with Congress to enact a Higher Education Act that provides access to quality education for all Americans.

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

Senate Permanent Subcommittee
on Investigations

EXHIBIT # 1

March 13, 1987

Management Improvement Report No. 87-06

TO: C. Ronald Kimberling
Assistant Secretary for Postsecondary Education

FROM: Mitchell L. Laine
Assistant Inspector General for Audit

SUBJECT: Guarantee Agency Record Dump Data Is Not Complete or Accurate

The purpose of this memorandum is to advise you of the quality of the Guarantee Agencies' Guaranteed Student Loan Program (GSLP) Record Dump Data currently being used by the Office of Student Financial Assistance (OSFA). Our survey work on the Fiscal Year 1985 data evidenced that it is neither a complete nor an accurate picture of any guarantee agency's operation. Complete and accurate data is needed for OSFA to meet the requirements of establishing internal controls and properly monitoring and managing the $60 plus billion GSLP. Management's use of the current data will result in the Department of Education (ED) making incorrect decisions in monitoring and managing the multibillion dollar GSLP.

BACKGROUND

OSFA recognized in 1976 that there were few sources of information to determine what was occurring at the guarantee agencies regarding the operation of the GSLP. To address this problem, OSFA and the agencies worked together in 1980 to establish a system to gather information on the agencies' GSLP data. The system became known as the "Student Loan Guaranty Record Dump Procedures," (hereafter referred to as "Tape Dump Procedures").

The Tape Dump Procedures were created by a joint committee of OSFA and the Paperwork and Data Processing Committees of the National Council of Higher Education Loan Programs (NCHELP). Tape Dump Procedures were published as the "U.S. Department of Education, State Guarantee Agency, Student Loan Guaranty Record Dump Procedures." These Tape Dump Procedures contained 42 pages of instructions and six appendixes on how each guarantee agency should prepare loan data.

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the data fields were left blank as shown by the following examples:

-- Enrollment Status, an important data field for evaluating in-school interest, contained over 1.5 million blank fields. This equates to $3.75 billion in GSLP loans without loan status codes indicating whether the borrower is in-school or not (1.5 million blank enrollment status or borrowers x $2,500 per loan = $3.75 billion in loans).

-- Loan Status Code, a code that indicates if a borrower is in-school, in deferment, paid-in-full, or dead, etc., had almost 400,000 borrower records with blanks. This says that 3.5 percent of the records did not show a borrower's status, which equates to a billion dollars of loans without status codes (assuming a loan amount of $2,500 x 400,000).

-- Loan Status Date showing when the loan status was last checked by each lender had over 425,000 blanks, amounting to $1.25 billion of loans.

-- Total Amount Approved for Academic Year which is used to check if borrowers are exceeding loan limits, had almost 2 million blanks. Also, if the total of approved loans is used for budget purposes, the total amount will be understated by 15-20 percent.

-- Beginning Period of the Loan had over 174,000 blank fields.

-- Ending Period of the Loan had almost 1.7 million fields with data missing. Beginning and ending loan periods are important data fields, in that they allow for a number of compliance checks, i.e., overlapping loans.

The OSFA evaluation indicated only two states did not use blank fields and that the remainder averaged over 350,000 blank data fields with one state having over 3.2 million blank data fields.

OSFA's 1985 guarantee agency data evaluation results call into question the use of the data as a source of analysis or oversight of the GSLP. This is based on the evaluation's results that showed on the average each borrower's record contains at least one blank data field. When key fields are left blank, neither ED nor the agencies have a reliable basis for using the data for budget or oversight purposes.

ED-OIG's Analysis Confirms the Limited Value of the Data

ED-OIG analyzed 1985 guarantee agency data using an audit software program (Audit Analyzer). Audit Analyzer programs

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The participation by guarantee agencies in providing the data has been, and still is, on a voluntary basis. ED does not have any regulations strictly requiring guarantee agency participation. Current regulations issued on November 10, 1986, merely state that, "A guarantee agency shall submit to the Secretary ... (4) Any other information concerning the loan insurance program, at such frequency as determined by the Secretary (34 CFR 682.414)."

ED states in the "Tape Dump Procedures" that the actual purpose for guarantee agencies providing their loan data to ED is "not yet ... fully defined." Nevertheless, an NCHELP committee published the following purposes for which ED planned to use the data:

-- prepare materials for budget purposes,

-- provide the General Accounting Office (GAO) with data,

-- provide for program oversight capabilities,

-- provide national statistical information by type of educational or lending institution,

-- produce statistics by individual state program,

-- provide each state with the identification of students receiving loans in more than one state, and

-- produce comparative information on state programs.

OSFA contracts with Boeing Computer Services to process the guarantee agencies' tapes. Boeing receives each agency's data tapes, edits the tapes, and compiles them into the agencies' GSLP tape dump. Boeing then prepares various analyses of the data. OSFA's cost for contracting with Boeing for Fiscal Year 1986 guarantee agency tapes was $1,056,303. This did not include expenses incurred by the agencies to create the data tapes.

GUARANTEE AGENCY DATA IS NOT COMPLETE OR ACCURATE

Evaluations of the data by OSFA and analyses by the Office of Inspector General (OIG) have shown that significant errors render the guarantee agency data of limited value in ED performing any oversight of the GSLP or for agencies evaluating their own operations.

OSFA's Evaluation of the Guarantee Agency Tapes

OSFA evaluated the 1985 data to ascertain data fields left blank. Of 300 million data fields from more than 12.5 million borrower records, over 20.1 million or 6.7 percent of were created to: 1) review the data for compliance with laws and regulations; 2) sort the data based on volume of potential problem areas, i.e., schools with high defaulted loan amounts, lenders with high number of "never enrolled"; and 3) create profiles on agencies, schools, lenders, and borrowers. These programs indicated potential problem areas in the range of $100 million to $224 million.

The Audit Analyzer program revealed:

-- Never Enrolled Borrowers Sorted by Lenders - this program indicated more than 85,000 borrowers, who received loans of more than $224 million, were shown as not attending school. In other words, the borrower could have received the loan funds and not have used the funds for educational purposes.

-- In-School Status Loans 5 Years Old and No Loan Status Update for 2 or More Years - this program identified loans totaling over $100 million where it had been 5 years since the borrower received a loan, and the loan status had not been updated from an in-school status for over 2 years by the lender.

The extent of the ED-OIG's analysis of the GSLP data was severely limited because of the large number of blank data fields. For example:

-- An analysis of the data will not produce an accurate total of defaulted loans. OSFA's analysis indicated that almost 400,000 loan status fields were left blank and we noted that one agency did not include any defaulted loans. Therefore, an analysis of default data would not be reliable because the data does not contain a complete universe of defaulted loans.

-- An analysis of schools obtaining 50 percent or more of their loans from one lender indicated that the data for loan status was inaccurate. For example, one lender had over 15,000 loans outstanding with none coded as defaulted. It is unlikely that a lender would have zero defaults with a portfolio of 15,000 loans.

-- Some agencies significantly overstated the number of borrowers and loans in their data by reporting all loans of a borrower rather than the last loan guaranteed.

ED-OIG's Testing of the Data Base Indicates Some Data Inaccurate

To test "Never Enrolled" data, we identified schools and lenders with borrowers that never enrolled. Our objective was to determine whether borrowers actually attended school.

We reviewed 54 borrowers shown as "Never Enrolled" at a school and found 41 borrowers did attend school. Therefore, the "Never Enrolled" data for that school was only 24 percent accurate.

A prior ED-OIG audit (ACN 04-40115) also noted a low accuracy rate for the GSLP data. Verification of loan data on about 1,200 borrowers showed this data to be about 50 percent accurate.

Budget Constraints

OSFA's previous Chief of the Guaranteed Student Loan Branch reported an underlying problem in that there is an insufficient budget amount to properly complete the guarantee agency data analysis. The former Chief stated in a memo dated 1985 and titled "Overview of Problem Areas, Major Issues and Initiatives Related to the Guaranteed Student Loan Program" that:

> "Program budget constraints and contractual demands hamper the ability to receive, process, and analyze borrower specific data from the guarantee agencies via the annual tape exchange. Program needs and operational priorities are not always in alignment."

In conclusion, because of the problems noted, OSFA's and NCHELP's objectives of complete and accurate data have not been met. Complete and accurate GSLP data is essential to related analysis for properly monitoring and managing the $60 plus billion GSLP. Currently, over $1 million per year is being expended to develop GSLP data and prepare reports that are of little or no value.

The Federal Managers' Financial Integrity Act and OMB Circular No. A-123 require management to establish controls which act as safeguards against "waste, loss, unauthorized use, and misappropriation." Implementation of the following recommendations should assure: 1) not only the annual GSLP data processing expenditure of $1 million will be better utilized, but 2) that ED has data to identify costly practices by the GSLP's agencies, lenders, schools, and borrowers.

The Higher Education Amendments of 1986 (P. L. 99-498) authorized ED to establish a national GSLP data base. However, because of start-up time needed to get a national GSLP data base operational, the current Guarantee Agency Record Dump of GSLP data should be improved and used in the interim, then used as a crosscheck in developing and establishing the national GSLP data base.

RECOMMENDATIONS Office Student Financial

We recommend that OSFA: → Assistance

1. not use the GSLP data without qualifying the data to the potential user as an inaccurate and incomplete source,

2. require agencies to submit complete and accurate GSLP data,

3. establish a procedure to verify the agency data,

4. issue regulations that act as Official Guarantee Agency Record Dump Data Guidelines, and

5. complete recommendations 1 through 4 then use the GSLP data to establish trend analyses and appropriate controls required by the law.

We would appreciate your views and comments concerning our recommendations within 30 days of the above date. If you have any questions or would like to discuss our recommendations, please contact me on 245-0621 or Carol Lynch, Chief, Postsecondary Education Audit Branch, on 472-6155.

Senate Permanent Subcommittee
on Investigations

EXHIBIT # 2

Response to Senator Nunn's question about the status of audits and Management Improvement Reports issued by the Department of Education's Office of Inspector General from FY 1987 through FY 1990.

OIG Final Audit ACN 04-30063, "Improvements Needed in Delivery of Vocational Training," March 10, 1987

OIG Recommendation #1: Office of Vocational and Adult Education (OVAE) and Office of Postsecondary Education (OPE) should coordinate the management of Federal funds flowing to both public and proprietary vocational institutions.

Corrective Action: The Department did not concur with the recommendation nor with the alternative methods suggested to achieve this recommendation. OVAE has taken some positive action along the lines of cooperation with the National Occupational Information Coordinating Committee (NOICC). To improve the availability and use of occupational information for career decision-making, NOICC's appropriation increase from $2.2 million in FY 90 to $3.5 million in FY 91. This was accomplished, despite the limited availability of Federal funds, in order to provide improved consumer information to current and potential students, for professional development and student assessment purposes.

We recognize that many proprietary schools take advantage of students and the availability of Federal funds. We believe, however, that the associations representing these schools are taking steps to improve the accreditation process and, thereby, force such schools either to improve their standards or risk having their accreditation, and consequently, their eligibility for Federal student aid programs in jeopardy. This is an appropriate role for such groups. ED is assisting such efforts through numerous tightened requirements in regulations governing the recognition of national accrediting agencies. To accomplish this, the following steps will be taken:

- The Department developed a Memorandum of Understanding to establish a joint OPE-OVAE Coordinating Policy Committee.
- The Committee is composed of senior level OPE personnel from the Office of Student Financial Assistance (OSFA), the Office of Higher Education Programs (OHEP), the Debt Collection and Management Assistance Service, and OVAE personnel as designated. (The Committee meets at least quarterly and establishes policy and procedures for the two offices in areas of mutual responsibility and interest.)

OIG Recommendation #2: OPE should conduct research to determine the extent to which unemployment causes defaults in loans under the GSLP, and ascertain actions needed, in addition to providing prospective students information about job opportunities, to reduce GSLP defaults.

Corrective Action: The Department commissioned a study in FY 1987 to assess Federal and contractor collection performance. As part of this Federal Collection Productivity Study, analysis revealed that States having lower unemployment rates tend to have higher percentages of debtors entering repayment and paying off larger portions of their debts. In summary, it appears that higher unemployment rates in a State are correlated with lower percentages of borrowers who live in that State paying their debts. A relationship between higher unemployment rates and lower percentages of debtors entering repayment is also likely.

In addition, on June 5, 1989, ED published in the Federal Register regulations that mandate institutions to advise prospective students of information about job opportunities for their particular vocational, trade, or career field.

OIG Management Improvement Report (MIR) 87-06, "Guarantee Agency Record Dump Data is not Complete or Accurate," March 13, 1987

OIG Recommendation #1: We recommend that OSFA not use the Guaranteed Student Loan Program (GSLP) data without qualifying the data to the potential user as an inaccurate or incomplete source.

Corrective Action: The GSLP and PLUS Tape Dump data are used to prepare a report on national demographic characteristics of GSLP borrowers. Data limitations are made clear in this report; the introduction to the report emphasizes that the results should only be used to make general statements about the characteristics of borrowers nationwide.

OIG Recommendation #2: We recommend that OSFA require agencies to submit complete and accurate GSLP data.

Corrective Action: Agencies are asked to submit complete and accurate data. Through the development of system edits, OPE makes every effort to identify errors and omissions in agency-reported data. Once detected, OPE identifies errors and omissions to the agencies who must then correct their tape submission. OPE has significantly improved its edit system over the last several years; further enhancements are currently underway.

OIG Recommendation #3: We recommend that OSFA establish a procedure to verify the agency tape data.

Corrective Action: The staff of the GSL Analysis Section evaluates the error listing of each agency, which is generated as a result of edits in OPE's computer system. Additionally, staff analyze data in an effort to detect errors which might not have been identified through the system edits. An evaluation report is developed and sent to each agency. Telephone follow-up is maintained on a regular basis to assure correction of problems identified.

OIG Recommendation #4: We recommend that OSFA issue regulations that act as official Guarantee Agency Record Dump Guidelines.

Corrective Action: To include such guidelines in regulations would be inappropriate, and would require rulemaking each time it was necessary to make even a minor modification to the Guidelines. However, a general description of the Tamp Dump was included in the "Records, Reports, and Inspection Requirements" of the regulations.

OIG Recommendation #5: We recommend that OSFA complete recommendation 1 through 4, then use GSLP data to establish trend analysis and appropriate controls required by law.

Corrective Action: OSFA is using statistical Tape Dump extract and management reports to establish trend analysis and to determine where additional controls are needed.

OIG Final Audit ACN 01-40013, "Audit of Reserve Fund Uses by Five Guarantee Agencies," July 27, 1987

OIG Recommendation #1: Recommend that the Office of Student Financial Assistance (OSFA) immediately promulgate a policy that clearly defines the functions considered necessary component of a guarantee agency's loan guarantee program. This definition should be incorporated into the GSLP regulations and include the classes of expenditures that would qualify as "payments necessary for the proper administration of the guarantee agency's loan guarantee program".

Corrective Action: Final Regulations published on November 10, 1986 (34 CFR 682.410) set forth the uses for which an agency may use the assets of its reserve fund. The guarantee agency may use its reserve fund monies (in addition to claim payments, etc.) only for payments necessary for the proper administration of the guarantee agency's loan guarantee program. Financing lender servicing functions, secondary market activities, etc., are not part of the agency's loan guarantee program. An agency's reserve funds could not be used for these purposes as of December 26, 1986, the effective date of the regulations. It is the Department's view that an agency's loan guarantee program consists of only those activities that an agency must perform which are required by Federal law, or regulation, or that are necessary to provide guarantees on loans and the additional functions incidental to the guarantee.

OIG Recommendation #2: OSFA should provide assurance that the previous uses of insurance premiums by guarantee agencies to finance lender activities are not in violation of the prohibitions in 34 CFR 682.401(b)(6). In those instance where the uses resulted in incentive payments to lenders or provided greater yields to lenders, the insurance premiums used for such purposes should be restored to the guarantee agency's reserve fund.

Corrective Action: A full program review of a guarantee agency's program operation does include an examination of prior insurance premium usage. Where the examination reveals that insurance premiums were improperly used, the agency is required to correct the situation.

OIG Recommendation #3: If OSFA agrees that the use of restricted reserve funds to finance lender activities is improper, OSFA should identify previous improprieties, which would include the Texas situation discussed in this report, and require the guarantee agencies to restore these amounts to their respective reserve funds.

Corrective Action: In the case of the Texas Guaranteed Student Loan Corporation, which used reserve funds to finance a loan servicing operation, the Department specifically approved the use of the agency's reserve funds for that purpose. Therefore, ED does not plan to ask Texas to restore the monies to the reserve fund. It should be noted however, that the use of the reserve fund for this purpose is not permissible as of December 26, 1986.

OIG Recommendation #4: We also recommend that OSFA closely monitor the investment practices of guarantee agencies through its on-site reviews and reporting requirements to ensure that reserve funds are used for low-risk securities, and that the investments have sufficient liquidity to ensure that the reserve funds are maintained for the purpose intended by regulations.

Corrective Action: The reserve funds are meant to support the guarantee agency's loan program. Therefore, ED agrees with OIG that the assets of the reserve funds should not be invested in securities with a high risk of loss. The GSL regulations 682.410(a)(5), provide that a guarantee agency may invest the assets of the reserve fund only in low-risk securities, such as obligations issued or guaranteed by the United States or a State, and shall exercise the level of care in such investment required of a fiduciary charged with the duty of investing the money of others.

The relevant phrase here is "in such investment required of a fiduciary charged with the duty of investing the money of others." Fiduciaries are bound by a set of laws that limit the way in which they can invest money which has been entrusted to them. OPE believes that by requiring agencies to adhere to these requirements we have sufficiently protected the Federal Government from risk of unreasonable loss.

OPE does not agree that the liquidity of the total reserve fund investments is of concern. The Federal Government reimburses agencies through the administrative cost allowance for administrative expenses and through reinsurance payments for defaulted loans. Although each agency must maintain sufficient liquidity to cover costs for periods of time during which it is awaiting reimbursement from the Federal Government, the reserves required to maintain this liquidity are very small relative to the total reserves available to most agencies (see GAO report, Guidelines for Reducing Guarantee Agency Reserves, GAO/HRD-86-129BR). Therefore, we do not believe that it is necessary to promulgate regulations in this area.

OIG Management Improvement Report (MIR) 88-01, "Participation of Aliens in Federal Student Financial Aid Programs," October 1, 1987

OIG Recommendation: Develop a "Dear Colleague" letter on the proper treatment of conditional residents, consulting with INS, as needed.

Corrective Action: OPE developed a "Dear Colleague" letter regarding the Marriage Fraud Amendments and their impact on SFA programs.

The "Dear Colleague" letter was mailed to institutions participating in the Pell Grant, campus-based, and Guaranteed Student Loan programs on December 28, 1987.

OIG Management Improvement Report (MIR) 88-03, "Financial aid Administrators Not Adequately Advised of Their Discretionary Authority to Adjust Pell Grant," December 11, 1987

OIG Recommendation: The Office of Student Financial Assistance should issue guidance as soon as possible to financial aid administrators on their expanded discretionary authority and responsibility for considering supplementary information on students' financial status and cost of education in determining eligibility and making adjustments to awards. This guidance should contain sufficient information, such as case studies or examples on what to consider, how to compute both upward and downward adjustments to Pell Grants, and what constitutes adequate documentation of adjustments.

Corrective Action: DPPD developed and distributed a "Dear Colleague" letter to institutions providing guidance on their discretionary authority to consider supplementary information and special circumstances of students in determining their eligibility for Title IV funds.

OIG Final Audit ACN 11-60269, "Review of the Guaranteed Student Loan/National Direct Student Loan Data Base," March 7, 1988

OIG Recommendation #1.1: Modify appropriate system programs so that borrower payments are applied first against accrued interest, then principal. In order to expedite this effort, consider using the methodology of existing programs in the NDSL collection subsystem which apply payments to borrower accounts.

Corrective Action: The redesign of the Department's debt collection system was completed and implemented on June 19, 1989.

OIG Recommendation #1.2: Consult with OGC to determine 1) if there is any legal impediment to retroactively adjusting accounts for which accrued interest has been incorrectly computed by the current system and 2) whether OPE can legally forgive the interest due by declining to make such adjustments.

OIG Recommendation #1.3: Recalculate accrued interest balances on all active accounts from start date to present, if OGC has no objections.

Corrective Action: The Department's Office of General Counsel (OGC) prepared a formal response regarding these two recommendations on August 4, 1988. OGC concluded that OPE is bound by the application of payments already made on FISL obligations and cannot change that application without the consent of the debtor. Because the application already made discharged the principal obligation to which it was credited, no interest accrued on that amount, and no claim exists for OPE to enforce or forgive. Therefore, the Department does not intend to recalculate or reapply payments as suggested in these two recommendations.

OIG Recommendation #2: Modify appropriate collection subsystem programs as soon as possible so that accurate past due balances are used to identify delinquent accounts for reporting purposes and for transfer to collection agencies or Internal Revenue Service (IRS).

Corrective Action: The system has been modified to accommodate both of the above described concerns as part of the complete system redesign that became operational on June 19, 1989.

OIG Recommendation #3.1: Issue procedures to regional offices requiring regional review staff to use the Interest Reasonability Report (IRR) and the Special Allowance/Regular Interest Exception Report to identify lenders for possible review. The procedures should not require review of all reports but should require a selective review of those test failures which past experience has shown to be reliable indicators of actual lender errors.

Corrective Action: The Department changed computer contractors and is spending considerable amounts of time on system conversion, testing, and start-up activities. However, once the necessary adjustments and modifications are made to the IRR, ED will provide the regional offices with procedures responsive to this recommendation.

OIG Recommendation #3.2: Modify system programs to enable users of IRR to select specific tests in order to reduce the size of the reports.

Corrective Action: Parameter edits were modified in an effort to reduce the number of IRR's generated. ED continues to work on the redesign of the interest and special allowance system.

OIG Recommendation #3.3: Resolve the nine potential billing errors for the six lenders reported. Information on specific cases has already been provided to appropriate OPE officials.

Corrective Action: The Department provided the cognizant regional offices with information regarding the override of billing tolerances for the six lenders identified by OIG. The regional offices included these six lenders in their review schedule.

OIG Recommendation #4.1: Ensure that system users are not in a position to decide which functions they should be authorized to access and that security reports are routed to individuals not responsible for operating the security system.

Corrective Action: After the award of the GSL/NDSL contract to National Computer Systems (NCS), new profile sheets were developed for each system user and reviewed and approved by the Department prior to implementation. Future changes to user profiles will be reviewed by a minimum of two people to ensure that system access is controlled. Security reports are now routed to NCS' Technical Support Section who are not system users. This section will review the reports and notify the appropriate programs Manager of potential problems.

OIG Recommendation #4.2: Ensure that passwords are 1) known only to the individual system users; 2) periodically changed; and 3) not used by more than one individual.

Corrective Action: 1) Each system user has been assigned a unique user identification number and has selected his or her unique password; 2) all passwords have been changed since the audit was conducted and will be changed every 30 days hereafter.

OIG Recommendation #4.3: Ensure that system access authorization is modified when individuals no longer need it.

Corrective Action: Passwords are known only to the individual system user. No written record is maintained listing the passwords of various users once a password is issued. All users are instructed that passwords are for their exclusive use and may not be used by other employees. System access has been updated. Only those individuals who need access have passwords.

OIG Recommendation #5.1: Ensure that master file changes, as evidenced by transaction history reports, are reviewed by individuals not responsible for operating the system program that inputs the changes.

Corrective Action: A procedure to audit all changes to the lender master file has been implemented in the Program Administration Section. Changes to the lender master file are now audited on a weekly basis by an individual who does not input the changes.

OIG Recommendation #5.2: Review the eligibility of lenders of who have not submitted a payment request within the past year and insure that inactive lenders are coded as ineligible to receive payments.

Corrective Action: As part of the redesign of the interest and special allowance system, lenders are sent a survey requesting information regarding their participation in the program. In addition, a lender participation questionnaire (LPQ) was developed and cleared by OMB to allow OPE to update the lender file. The redesign was completed and implemented on June 9, 1989.

OIG Recommendation #5.3: Establish a separate code on the lender master file to designate those lenders who are no longer eligible to receive payments but should continue to receive program literature. Discontinue using the interest and special allowance payment eligibility code for this purpose.

Corrective Action: As part of the redesign of the interest and special allowance system, lenders are sent a survey requesting information regarding their participation in the program. In addition a lender participation questionnaire (LPQ) was developed to enable OPE to update the lender file. The actual redesign was completed and implemented on June 9, 1989.

OIG Management Improvement Report (MIR) 88-06, "Proposed Improvements for Collection of New Loans Due from Previously Identified Debtors," May 24, 1988

OIG Recommendation #1: Determine whether all new loans due from previously assigned debtors have been entered on all of the collection contractors' systems.

Corrective Action: On May 3, 1988, all contractors were notified that the ED-Monthly Accrual Interest Update Tapes may contain both new and old loans.

The contractors have all made changes in their procedures to insure that their systems are updated with current balances and can recognize when a new loan is received.

OIG Recommendation #2: Review and revise the update tape so that new loans are more easily identified.

Corrective Action: The Debt Collection System that was implemented on April 1, 1989, does identify all new loans transferred to the contractor.

OIG Final Audit ACN 11-70262, "Review of the Office of Postsecondary Education's Check Handling and Deposit Procedures," July 15, 1988

OIG Recommendation #1: OIG recommends that ED ensure that written procedures state that checks must be deposited in accordance with the Treasury Financial Manual (TFM).

Corrective Action: ED has revised the current procedures to incorporate the requirements specified in the TFM for deposits of checks.

OIG Recommendation #2: ED should provide personnel involved in the check handling and deposit process with a copy of the new procedures (referred to in recommendation #1) and train them in the process.

Corrective Action: The personnel involved in the check handling and deposit process received copies of the revised procedures. Internal spot-check reviews are conducted to assure that the procedures are being followed. ED also conducted training sessions for personnel on the check handling and deposit process.

OIG Recommendation #3: ED should designate backup personnel to handle deposit functions when regular staff are not available; in addition, ED should assign an individual to be responsible for coordinating and supervising the collection and deposit function for all of its offices.

Corrective Action: The Chief of Management Services and Analysis Section (Division of Program Operations and Systems, Campus-Based Branch, OPE) and the Fiscal Analyst serve as backup personnel to the check handling and deposit process; they also coordinate and supervise these functions.

OIG Recommendation #4: OIG recommends that ED implement procedures which assure that checks are safeguarded by providing all offices access to a safe.

Corrective Action: A memorandum dated May 24, 1988 was distributed to all OPE offices regarding access to the safe located in 4640, ROB-3. A log has been initiated for safeguarding checks. Procedures for safeguarding checks have been incorporated in the Check Handling and Deposit Procedures.

OIG Recommendation #5: OIG recommends that ED implement procedures which assure that checks are endorsed immediately upon receipt.

Corrective Action: The Management Services and Analysis Section as well as the Pell Alternate Disbursement System, Regular Disbursement System, and the Campus-Based Branch have been reminded that checks must be endorsed immediately upon receipt prior to photocopying. The check handling and deposit process procedures include a sub-heading on Endorsing Checks that emphasizes that checks must be endorsed upon receipt.

OIG Recommendation #6: OIG recommends that checks received in the Division of Training and Dissemination (DTD) be recorded in a check receipt log and promptly delivered to the correct office.

Corrective Action: A meeting was held with the Chief, Information Section, DTD, regarding checks received in DTD. Checks received in DTD are recorded in the Check Receipt Control log and delivered promptly to the correct office.

OIG Recommendation #7: OIG recommends that ED implement procedures which assure that the armor car log is filled out completely and verified by OPE personnel daily.

Corrective Action: The armor car log is verified and completely filled out by ED personnel. Spot-check reviews are performed by the Fiscal Analyst.

OIG Recommendation #8: OIG recommends that ED implement procedures which assure that check receipt data are accurate in the check control log.

Corrective Action: ED personnel were informed that the check receipt date is the date to be entered in the check receipt control logs. Data entries for the check receipt control logs have been incorporated in the procedures. Spot-check reviews will verify the date of receipt on the check to ensure compliance with procedures.

OIG Recommendation #9: ED should develop procedures which assure that deposit tickets are dated the same day as they will be presented to the bank.

Corrective Action: ED personnel were advised that the date on the deposit ticket must coincide with the date of deposit. Procedures require ED personnel to verify the date on the deposit ticket before presenting it to the bank.

OIG Management Improvement Report (MIR) 89-02, "ED Has Determined Certain Institutions to be Eligible for the Student Financial Assistance Programs Without Verifying Data on Course Length," December 23, 1988

OIG Recommendation: ED should change its procedures and develop regulations, if needed, to ensure that hours (clock hours, hours of preparation, or credit hours), weeks and/or months reported by institutions and used by ED to determine eligibility to participate in specific student financial assistance (SFA) programs are verified.

Corrective Action: Prior to, during, and subsequent to the OIG review and issuance of the MIR, the following events occurred that resolve the MIR recommendation to change procedures so that course length of correspondence courses is verified:

Under an agreement dated September 7, 1989 between the Department and the National Home Study Council (NHSC), NHSC has agreed to verify the number of clock hours in correspondence programs and correspondence components of combined correspondence/residential programs stated by institutions in eligibility applications submitted to the Department. NHSC has further agreed to notify the Department of whether or not it agrees with the number of clock hours stated by an institution in its application.

Presently, the Division of Eligibility and Certification (DEC) is using this NHSC procedure to review the applications of institutions that are applying for the first time for institutional eligibility, undergoing a change of ownership, or undergoing a periodic renewal of eligibility. Beginning October 1, 1990, DEC expanded its review to include all institutions accredited by NHSC.

DEC now has the authority, under the Emergency Action regulations, to take adverse action against institutions that fail to have NHSC validate the number of clock hours in their correspondence programs and combined correspondence/residential programs.

OIG Management Improvement Report (MIR) 88-08, "Correspondence Schools Accredited by the National Home Study Council (NHSC) May be Overcharging Certain Students for Registration Fees and Equipment Due to an Inappropriate Refund Policy," August 17, 1988

OIG Recommendation: Advise NHSC to immediately instruct those schools that it has accredited that these practices (inappropriate refunds must be made to any students who were overcharged for registration fees or equipment, and that it revise its refund policy guidelines so that these types of overcharges will not occur in the future.

Corrective Action: OPE staff met with representatives of the NHSC; the council subsequently revised its refund policy to state that registration fees should be subtracted from total tuition prior to calculating the percentage of refund due a withdrawing student. Additionally, NHSC developed a new standard which explicitly states that upon cancellation, students whose tuition is paid in full are entitled to receive all course materials including kits and equipment.

OPE is currently writing "Dear Colleague" letters that it will send to institutions and accrediting agencies. These letters will describe a refund policy for materials and equipment, which OPE believes can be universally applied and which satisfies our regulatory requirement for fairness and equitability. We will recommend in our "Dear Colleague" letters that institutions and agencies modify, as necessary, their respective refund policies to correspond with OPE's policy.

OIG Management Improvement Report (MIR) 88-09, "OSFA Needs to Conduct Program Reviews at Student Financial Aid Servicers," August 18, 1988

OIG Recommendation: OSFA should establish and implement procedures to conduct program reviews of servicers. If it does not have the authority, it should take the necessary actions to obtain the authority.

Corrective Actions: We expect to publish a NPRM in 1991.

OIG Management Improvement Report (MIR) 89-05, "Cost Savings Opportunities in the Procurement of Multiple Data Entry Services," February 7, 1989

OIG Recommendation #1: The Department should award all contracts for Multiple Data Entry (MDE) form processing in a more competitive environment with no predetermined number of MDE contracts to be awarded.

Corrective Action: The Department has eliminated participation criteria that existed in the previous procurements from the new MDE procurement. The participation criteria were thought to be too constrictive to permit a full and open competition. The Department expects that more favorable costs will be obtained by allowing contractors previously excluded under the old participation criteria to bid. The number of MDE contracts awarded will be dependent on the number of proposals that successfully meet the Department's technical and business evaluation requirements. However, the Department will also take into account the legislative intent of the MDE system to reduce student filing burden when making the determination of MDE contract award(s).

The MDE RFP, issued November 1988, completed this action.

OIG Recommendation #2: The Department should perform a detailed cost benefit analysis to determine the desirability of continuing to fund both the MDE and Application for Federal Student Aid (AFSA) systems for determining student eligibility for the Federal student financial aid programs.

Corrective Action: We concur with the recommendation that a detailed cost benefit analysis should be performed to compare the costs of processing Applications for Federal Student Aid by a central processor with the costs incurred through contracts with a number of MDE agencies. We hope to commence the study in March 1991. We will consult with the OIG on the specifications for the study as they are developed and keep them informed of the progress of the study while it is under way. And, of course, we will share the results when the study has been completed.

OIG Recommendation #3: The Department should explore the possibility of a legislative change by Congress to restrict MDE processing to a single, nationwide contractor, similar to the current Application for Federal Student Aid processing.

Corrective Action: In theory, selection of a single nationwide contractor may produce cost savings to the Government (i.e., an "economy of scale" effect). However, the Department must continue to be cognizant of the legislative intent of the MDE system. Prior to implementation of the MDE system in the 1978-79 processing year, students were often faced with a multiplicity of forms to complete in order to apply for student financial aid. The MDE processors, in serving their State and institutional clients, provide a means by which a student can apply for State and institutional as well as Federal aid on a single application form, thereby reducing student filing burden. If a single MDE were to exist it is unlikely it could meet the varied needs of all institutions and States in the manner in which those needs are met under the current system. If those needs were not met the result would undoubtedly be a proliferation of supplementary forms at the State and institutional level. An important concern of the Department in the Title IV Delivery System is having backup processing capability to ensure processing prior to the award year. MDE points provide the backup not available with one processor. Moreover, it is possible that one bidder might have all of the Title IV contracts and not be able to deliver.

We believe that under the current legislation, ED is afforded sufficient flexibility in selecting the "optimal number" of MDE contractors, and therefore, changes to the legislation would not prove advantageous.

The Department is currently studying this issue as it prepares for the reauthorization of the Higher Education Act. When the Department makes recommendations for reauthorization in early 1991, this issue will be addressed.

OIG Management Improvement Report (MIR) 89-06, "Proposed Procedures to Prevent Stafford Loans with Unissued Social Security Numbers from Being Guaranteed," March 8, 1989

OIG Recommendation: Inform the State guarantee agencies of the problems if they have unissued social security numbers (SSN) in their database. Research the possibility of adapting the Health and Human Service/OIG SSN check program for use in testing the validity of the SSNs reported by Stafford Loan borrowers.

Corrective Action: The Department had initially drafted a "Dear Colleague" letter to guarantee agency directors that discussed the problems arising from invalid SSNs in the loan collection process. However, based on discussion with the Department of Health and Human Services (HHS) that letter was recently withdrawn. HHS prefers to work directly with the Department rather than with guarantee agencies in using the SSN check program to assist in detecting invalid SSNs. We are continuing to examine the feasibility of entering into an agreement directly with HHS/OIG.

OIG Final Audit ACN 11-70191, "Controls Over Debt Collection Contractors," July 10, 1989

OIG Recommendation #1: Assure that the two missing deposits are credited to ED's account by Treasury.

Corrective Action: The missing deposits were credited to ED's Treasury account on February 13, 1989.

OIG Recommendation #2: Provide Financial Management Service (FMS) with appropriate deposit information for fiscal years 1987 and 1988 so that a reconciliation can be performed to assure that all deposits and returned checks were properly posted to the ED Treasury account. Work with FMS to resolve any differences and take appropriate action to adjust any commissions paid incorrectly.

Corrective Action: OPE has provided FMS with all the appropriate deposit information for fiscal years 1987 and 1988 and have worked with the FMS staff to resolve all differences as they arose. OPE will continue to assist in problem resolutions as needed.

OIG Recommendation #3: Replace the manual method in which the Division of Program Operations and Systems (DPOS) receives and records deposit and return check slips in the general ledger. For example, ED should evaluate the feasibility of having the GSL subsystem send the deposit data by tape transfer to the general ledger. A tape transfer would eliminate manually entering the same deposit data into different systems.

Corrective Action: ED is routinely reporting all collection transactions to the general ledger via magnetic tape, and has discontinued the manual entry of deposit and return check slips.

OIG Recommendation #4: Establish procedures for the regional offices to account for returned check debit vouchers and credit memoranda from the Federal Reserve Bank (FRB) in a consistent and appropriate manner.

Corrective Action: The regional offices no longer perform deposit functions as a result of the expiration of the current private collection contracts. The follow-on collection contractors will not be responsible for payment entry. Therefore, only the National Payment Center in Iowa City will be depositing payments, ED will deal only with the Des Moines FRB. The contractor has procedures in place to account for all debit and credit memoranda.

OIG Recommendation #5: Assure that all collections used as a basis for commissions are reconciled to the Treasury statement.

Corrective Action: During the 1st quarter of FY 90, ED began the process of reconciling collections with Treasury statements, including those used to form the basis for collection agency commissions.

OIG Final Audit ACN 01-60060, "The Administration by the Department of the State Student Incentive Grant Program," July 11, 1989

OIG Recommendation: The State Student Incentive Grant (SSIG) section of the Office of Student Financial Assistance should establish appropriate administrative controls to ensure that States, in their annual applications for SSIG funding, reasonably define the term "substantial financial need" for the Secretary's approval.

Corrective Action: The SSIG section revised the SSIG application form to require a description of a State's criteria in determining substantial financial need effective with the fiscal year 1988 application.

The SSIG Section developed a guide to determine substantial financial need in the SSIG program in order to provide guidance to the SSIG Section staff and States regarding acceptable standards for substantial financial need in accordance with the applicable program regulations and statute. The guide was included as an enclosure with the 1989-90 (fiscal year 1989) application sent to each State. The application cover letter to the States emphasized the Department's concern that States have satisfactory criteria for determining substantial financial need.

The SSIG Section also developed two new internal edit checks to ensure that States have appropriate standards for substantial financial need. The first requires the staff person evaluating a State application to determine that the State's criteria as reported in the application provided a specific parameter for substantial financial need. The second requires the staff person to determine that, based on the State's particular circumstances, the parameter is reasonable for concluding that a student applying for an SSIG has "substantial" financial need as opposed to minimal need.

OIG Final Audit ACN 04-70013, "Audit of the Effect of the Restrictive Filing Requirement Contained in Public Law 99-498, Section 428(c)(1), on the Efficient Use of Federal Funds Within the GSLP," July 11, 1989

OIG Recommendation #1: ED should require guarantee agencies to pay lenders' claims as quickly as administratively possible.

Corrective Action: The Department agrees that agencies should not delay paying claims. The Department is developing a proposed regulation that would address the payment of lenders' claims by guarantee agencies.

OIG Recommendation #2: ED should request legislative action to repeal the prohibition that guarantee agencies cannot apply for reinsurance prior to the 270th day of borrower delinquency.

Corrective Action: The Department did not agree with this recommendation. ED believes a repeal would unnecessarily increase program cost.

The Government would have to make a one-time payment of 60 to 75 days' worth of reinsurance claims, which would be absorbed by the GAs. Based on the level of reinsurance payments made to guarantee agencies in FY 89, the Department estimates that expense to be between $317 and $396 million. This further supports the Department's view that a regulatory change to require agency payment of claims within 45 days rather than the current 90 days to be feasible.

OIG Final Audit ACN 11-80180, "Review of the Campus-Based Financial Management Subsystem" August 17, 1989

OIG Recommendation #1: Perkins Loan funds should be allocated more efficiently.

- Clarify with the OGC whether or not Campus-Based Branch (CBB) would be acting within the law by allocating Perkins program funds based on funds received instead of the current method of using the highest authorized level.
- If OGC agrees that Perkins program funds can be allocated based on funds received (i.e. final authorized levels), then CBB should implement this method of allocating with the next award year.

Corrective Action: The Office of Postsecondary Education did consult with OGC regarding this matter. Their opinion was that the Department could legally interpret the word "received" in the Higher Education Act, Section 462(a)(1)(A), to mean either the authorization received or cash received by an institution of postsecondary education. Our previous interpretation had been the authorization, and OIG's recommendation was cash. OIG's concern was that determining subsequent year funding levels based on the amount authorized for receipt in the 1985-86 Award Year, instead of the amount of cash received, rewarded some institutions in subsequent years for under-utilization in 1985-86. OPE agreed to accept OIG's recommendation effective with the 1990-91 Award Year. This action will result in the annual re-distribution of approximately $16 million from nearly 400 institutions with 1985-86 under-utilization (i.e., failure to spend the amounts allotted) to about 2,100 other institutions which fully utilized their 1985-86 Federal funds and have a need for additional Federal capital.

OIG Recommendation #2: Accounts are not closed at year end on a timely basis.

- Work with ED's Financial Management Service (FMS) to develop a user's report that would sort open account transactions by highest dollar amount.
- Using the open account report, reconcile and close the current unexpended balances.
- Develop and implement procedures that would ensure a complete reconciliation of all year-end open accounts.

Corrective Action: Database records were corrected. Awards for 1985-86 and 1987-88 were reconciled and closed as of May 31, 1990.

OIG Recommendation #3.1: Accounts receivable records cannot be relied upon for financial reporting purposes.

- Create and maintain adequate accounts and loans receivable records for institutions in the closed and liquidating status.
- Provide timely and accurate reporting of all receivables on Schedule 9 - Report on Accounts and Loans Receivable Due from the Public, which is sent to Treasury and the Office of Management and Budget (OMB).
- Contact the Office of Management's FMS to discuss the feasibility of transferring to them accounts receivable collection activities for closed and liquidating institutions. In the event a transfer cannot be done, establish and implement collection procedures, including follow-up procedures for institutions failing to make repayments.

Corrective Action: The PC-based Tracking Institutional Payment System (TIPS) became fully operational in January 1990. All schools are now reported on Schedule 9; adequate loan accounts have been established and are being maintained. FMS has and does establish a receivable for closed institutions and those that are liquidating the Perkins Loan Fund by submitting the Federal share of the funds collected on outstanding loans. Completed May 31, 1990.

OIG Recommendation #3.2: 1. Request immediate repayment of all Teacher/Military Cancellations (TC) overpayments owed the Department. 2. Develop and implement procedures to ensure that all future TC overpayments are collected immediately.

Corrective Action: Receivables were checked, errors detected, corrections were made. After establishing accurate receivables, procedures were developed and implemented to ensure timely payment. Completed April 30, 1990.

OIG Recommendation #3.3: 1. Update the current ledger records to determine the status of each outstanding institutional loan account. 2. Request immediate repayment, including interest, on all delinquent accounts. 3. After records are updated, ensure that the proper amount is reported on the Schedule 9 report. 4. Maintain up-to-date records for all future Section 207 Loans to Higher Education Institutions, which provided the institutional capital contribution for the National Defense Student Loan Program. 5. Contact ED FMS to discuss the feasibility of transferring Section 207 loan operations to FMS's Loans and Accounts Receivable Branch.

Corrective Action: OPE staff audited accounts for each institution and, as necessary, issued billing statements reflecting principal and interest due from the date of last payment to the statement due date. This audit was completed in January 1990. The Tracking Institutional Payment System (TIPS) is employed to monitor payment activity. OPE decided not to contact ED-FMS regarding the possible transfer of accounts because the number of remaining outstanding loan balances is so few that such a transfer of responsibility would not be cost effective - OPE will therefore maintain responsibility for this activity.

OIG Recommendation #4: Campus-Based Systems (CBS) contains significant control weaknesses.

- o Develop and implement procedures to ensure that all manual award adjustments are accurately documented and entered into CBS.
- o All error reports corrected by the institutions should be followed-up until all errors are cleared from the edit report.
- o Develop and maintain a log of all on-line transactions made by Campus-Based Branch personnel. Also, develop and implement procedures which would segregate all on-line transactions between individuals authorizing the adjustments, imputing the data, and reviewing the results.
- o Correct CBS to report a negative number on the edit report when a negative number is in the database, and ensure that this negative number is recorded as an error message.

Corrective Action: All OIG recommendations were implemented by December, 1989.

OIG Final Audit ACN 06-70200, "Need for More Aggressive Collection of Perkins Loan Excess Cash By Office of Postsecondary Education," August 16, 1989

OIG Recommendation #1: Identify those institutions with excess cash and require prompt return of the Federal share which we estimate to be approximately $264 million as of June 30, 1987.

Corrective Action: The Department concurred with the recommendation, with the exception of the amount involved.

- o The Department disseminated a letter to institutions with cash-on-hand balances in excess of $5,000 as of June 30, 1988, that had not issued loans to students during the past three award years. This resulted in a return of $1,603,373 to the Department. ED issued a similar letter to **all** institutions reporting zero funds advanced to students during the 1987, 1988, and 1989 award periods that reported a cash-on-hand balance as of June 30, 1989. The report of collections from the National Finance Center (NFC) indicates that $862,974 was received as NDSL/Perkins Loan funds during February 1990. Payments received as a result of letters sent based on cash-on-hand balances as of June 30, 1990 are being processed.

- o The Department also disseminated a letter to institutions with a ratio of cash-on-hand to annual expenditures of 150 percent or more which produced a return of $5,512,098 during the period of April through July 1989. In addition, 15 institutions released some or all of the 1989-90 allocation awarded to them, and 82 institutions received permission to retain the funds based on the explanation and/or analysis presented to OPE.

In April 1990, OPE issued a follow-up letter to all applicable nonrespondents. This is an annual cycle of activities and will continue as long as the NDSL/Perkins Loan Program has an excess cash issue.

OIG Recommendation #2: Establish written procedures for prompt continuous collection of excess cash. Those procedures should include development of criteria for identifying and contacting institutions with potential excess cash, requiring return of the excess, follow-up on nonrespondents and assessing the reasonableness of requests to retain funds. The procedures should also include controls to assure that the criteria are consistently applied, analyzed for adequacy, and revised as needed.

Corrective Action: The Department concurs with this recommendation and in addition to the initiatives in Recommendation 1, the following measures have been taken:

- o The Division of Audit and Program Review (DAPR) now closely monitors findings of excess cash through audits and program reviews. Sanctions include reimbursement of excess cash to the Department and informal fines.

- The Office of Management (OM) agreed to notify OPE quarterly of an institution's submission of excess cash due to an audit or program review.
- The Audit Review Branch forwarded, to the Office of Inspector General (OIG), supplemental audit steps for Perkins Loan excess cash that will be included in the revised Audit Guide.
- The Institutional Review Branch revised its Program Review Core Items Guide by incorporating guidelines for the review of Perkins Loan excess cash. The Division of Program Operations and Systems provided DAPR information on institutions with Perkins Loan excess cash.
- OPE developed procedures for identifying and contacting institutions having potential excess cash problems.
- The tracking system for excess cash schools was developed and is in place.

OPE will monitor the initiatives and initiate any revisions needed. This is an ongoing activity.

OIG Recommendation #3: Incorporate statutory provisions and guidance regarding excess cash in the Perkins Loan Program regulations and seek, if needed, authority to limit new Federal Capital Contributions (FCC) allocations for those institutions which continued to maintain excessive cash-on-hand.

Corrective Action: 1. The development of uniform procedures for the recovery of excess cash have been accomplished under Recommendations 1 and 2 above.

OIG Final Audit ACN 11-80160, "Financial Analysis Certification Process Not Adequate to Protect Students and Government," September 15, 1989

OIG Recommendation #1.1: Instruct the Institutional and Lender Certification Branch (ILCB) to deny certification or recertification to schools that do not meet the financial responsibility tests.

Corrective Action: This recommendation has been implemented on initial applicants. Those institutions that are applying for recertification and do not meet the standards of financial responsibility but have documents that prove financial strength may be afforded the opportunity to post a surety as a means of improving their financial condition.

OIG Recommendation #1.2: When ILCB denies certification, it should refer the institution to its accrediting organization and request that the institution's accreditation be re-evaluated.

Corrective Action: This has been implemented. When an institution has been denied certification, a letter is sent to the institution advising of the denial and another letter is sent to the accrediting body advising of the denial and reason for denial.

OIG Recommendation #1.3: Change the emphasis of Management by Objectives (MBO) reports to encourage careful screening of applications instead of a certification quota.

Corrective Action: ED agrees that proper screening is of foremost importance. However, there is not now, and has never been, a quota for certification.

OIG Recommendation #2.1: Amend the certification application form (ED Form E40-34P 9/88, line 30, Financial Responsibility) to require institutions to submit the required financial statements for the institution's latest complete fiscal year and its current fiscal year in accordance with 34 CFR 668.13(e).

Corrective Action: ED disagrees with this recommendation because it deems the analysis of part-year reports to be of limited value.

OIG Recommendation 2.2: Require that all institutions submit financial statements certified by an independent public accountant as a prerequisite to certification or recertification.

Corrective Action: The Department is working on a change in regulations to implement this recommendation.

OIG Recommendation #2.3: Assess the risk of loss to both students and the government by obtaining projected cash advance information from each new institution and by obtaining Financial Management Section (FMS) cash advance reports and student financial aid data for each institution it recertifies.

Corrective Action: This has been implemented. The Department requires each initial applicant to project its enrollment and student aid receipts. In addition, the Institutional Data System is queried to determine Title IV receipts on recertification.

OIG Recommendation #2.4: Purchase a financial analysis software package to use on personal computers. By analyzing an institution's financial statement information with a comprehensive software package, Financial Analysis Section (FAS) could perform a more extensive financial analysis. FAS could also include a decision table in the computer that would offer certification options. In addition, the information analyzed each year could be maintained and compared to future years' financial data. This would allow FAS to perform various trend analyses. Also, the computer could be used to access the school's historical Title IV funding data to determine the extent of its participation in the programs and to assess the risk of certifying the school.

Corrective Action: The request for a financial analysis software package was included in OPE's technology budget request for fiscal year 1991. Upon approval, the software will be purchased.

OIG Recommendation #2.5: Use credit reports from outside credit agencies in all financial analyses.

Corrective Action: ED now uses credit reports.

OIG Recommendation #2.6: Provide FAS analysts and managers with periodic training in financial analysis techniques.

Corrective Action: The training budget for fiscal year 1991 included a request for training dollars to address this recommendation. Pending budget approval, training will be provided.

OIG Recommendation #2.7: Require that all schools be recertified on a periodic basis (e.g., not less than every 4 years) to assure that they continue to meet the minimum criteria.

Corrective Action: ED requested increases in staff in the fiscal year 1991 budget to address this recommendation. Pending budget approval, training will be provided.

OIG Recommendation #2.8: Require institutions to provide financial statements for the two most recent complete fiscal years and an interim report on the institution's current financial condition to FAS for review.

Corrective Action: This recommendation was addressed through revision of the application package.

OIG Recommendation #2.9: Revise the certification form to require the school's president as well as its chief executive officer to certify the accuracy of all information provided as part of the certification review.

Corrective Action: OPE added the revised certification form to the application package.

OIG Recommendation #3.1: Require that surety arrangements be made at a level sufficient to cover both the students' and government's risk of financial loss.

Corrective Action: The current surety arrangements have been increased to comply with this recommendation.

OIG Recommendation #3.2: Increase surety arrangements currently in force to the extent necessary to assure that the risk of loss to both students and the government is adequately covered.

Corrective Action: Although certain contractual and legal problems are inherent in an attempt to impose increased surety requirements during the term of existing certification, current surety arrangements have been increased.

OIG Recommendation #3.3: Develop a policy that outlines the conditions where a surety arrangement must be obtained by an institution before it can be certified or recertified. The policy should also state that if a school fails to keep its surety arrangement in effect, then it will lose its certification.

Corrective Action: OPE has implemented this recommendation.

OIG Recommendation #3.4: Amend the standard surety agreement so that the proceeds also can be used to cover the government's losses when a school closes.

Corrective Action: ED plans to amend the surety agreement. To that end, we have sent a revised surety agreement form to the Surety Association of American to request reaction as to its acceptance by the industry.

OIG Recommendation #3.5: Discontinue using corporate pledges of assets as a form of surety arrangement and replace existing corporate asset pledges with irrevocable letters of credit.

Corrective Action: Corporate pledges of assets are no longer accepted by OPE.

OIG Recommendation #3.6: Develop a tracking system to monitor the status of surety arrangements. The system should be designed to alert schools well in advance of the need to continue surety coverage. In addition, Institutional Lender Certification Branch (ILCB) needs to develop a policy and a procedure so that appropriate and consistent action will be taken when schools fail to comply with certification conditions.

Corrective Action: A tracking system is in place to monitor the status of surety arrangements.

OIG Recommendation #3.7: Direct that FAS and DAPR coordinate their efforts to ensure that the proceeds of all surety arrangements are collected in a timely manner.

Corrective Action: Procedures have been established to ensure the timeliness of collection of the proceeds of all surety arrangements.

OIG Recommendation #3.8: Refer the six uncollected surety arrangements to the Office of the General Counsel for legal action.

Corrective Action: This has been implemented.

OIG Recommendation #3.9: Require that schools receiving a certain percentage, or dollar, threshold of Federal funds, as compared to all funds received by the school, be required to obtain a surety agreement from a company holding certificates of authority as acceptable sureties (31 CFR Part 223) for an amount that protects both students and the government from the risk of loss in the event that the school closes without providing all educational services.

Corrective Action: This issue is being reviewed by the Department's attorneys to determine the action which ED can take.

OIG Management Improvement Report (MIR) 89-09, "Stretching of Training Programs Beyond the Length Needed to Prepare Students for Gainful Employment," September 27, 1989

OIG Recommendation #1: It would be worthwhile to consider doing or contracting for a study which would enable the Department to establish guidelines for determining course lengths that are reasonable and necessary to prepare students for gainful employment in various occupations, e.g., security guards, manicurists, etc. In establishing those guidelines, OPE should work with groups such as other Federal agencies which fund training, State licensing and regulatory agencies, accrediting agencies, industry experts, professional groups and public institutions.

Corrective Action: The Department does not think a study is necessary. On October 1, 1990, the Department published a notice of proposed rulemaking that would establish conversion ratios between clock hours and credit hours for use in determining aid eligibility. This would permit a standard measurement for judging the amount of training provided to a student in any undergraduate vocational training program. Congress recently extended the open comment period on the proposed regulations through January 1, 1991 (P.L. 101-589).

Due to the statutory limitations on the Department's authority to set curriculum standards, we have allowed institutions considerable flexibility in determining the length and intensity of courses. We recognize that this has led to abuses by some institutions.

OIG Recommendation #2: The Department should seek legislative authority for approving course length, assign clear responsibility for determining course length, and establish a mechanism for monitoring that determination.

Corrective Action: The Department agrees with the recommendation. This issue is under review for reauthorization.

OIG Recommendation #3: Students should be encouraged to seek training courses which qualify them for gainful employment in their chosen occupations in the shortest reasonable period of time. Some help against the course stretching problem would be achieved in the short-term if required consumer information were expanded to include discussion of training options and considerations such as course length and cost in light of expected earnings.

Corrective Action: The Department is developing a proposed regulation that would require an institution to disclose information regarding anticipated earnings in a given occupation in the consumer disclosure provisions of 34 CFR 668.44(c)-(f). However, Public Law 101-542 has suspended this provision to allow the Department and Congress an opportunity to analyze the feasibility of making such information available to students and prospective students.

OIG Management Improvement Report (MIR) 90-01, "The Office of Postsecondary Education's Institutional Data System (IDS) Needs Improvement," November 3, 1989

OIG Recommendation #1: Recommend that the Division of Eligibility and Certification (DEC) review all its eligibility and certification supporting files and enter all the missing information for each institution that has certification files without having eligibility files. The IDS edit checks should be revised to prevent this from recurring. If entering all the missing data in the IDS would require too much of DEC's staff time, then OPE should seek another solution such as awarding a contract to complete the task.

Corrective Action: As of August 1990, permanent ED staff, as well as temporary and contract personnel completed a review and update of all eligibility files. This action included the input of data where the IDS indicated a certification file but no date regarding eligibility. System adjustments have been made which precludes entry of data into the certification file without establishment of an eligibility file for the institution.

OIG Recommendation #2: Modify the IDS eligibility file to indicate when an institution's eligibility is due to be redetermined. Assure that DEC updates the eligibility and certification files the same month it becomes aware of changes in an institution's eligibility status.

Corrective Action: In April 1989 the "Expire Date" field was added to the eligibility file. This field is updated when an eligibility letter is issued by the OPE-IDS. This field represents the date the eligibility of the institution should be redetermined.

Procedures have also been implemented to ensure that the eligibility and certification files are updated the same month that a change in eligibility status is received.

OIG Recommendation #3: Establish procedures to assure that the Division of Audit and Program Review (DAPR) updates the audit file upon receipt of the reports and to further update this information upon issuance of the final Department decision. The audit file should also be periodically matched against the funding file to identify institutions which have received SFA funds and are delinquent in submitting their audit reports.

Corrective Action: Audit files are updated upon receipt of reports and final Department decisions. Procedures are maintained to track institutions that require audits prior to receiving student financial assistance funds.

OIG Recommendation #4: Require the ADP Resource Management Staff to obtain the Guaranteed Student Loan (GSL) Tape Dump from the GSL Policy Branch when it becomes available each year and input the data to the Funding File including the SLS and PLUS programs.

Corrective Action: With assistance from OIG staff, the 1987 tape information was loaded into the funding file by GSL program. The funding file now contains annual volume and number of borrowers from 1987 to 1990.

OIG Management Improvement Report (MIR) 90-02, "Improving Ability to Benefit Determinations and Related Admissions Practices in the Department's SFA Programs," November 15, 1989

OIG Recommendation #1: Recommend that the current legislative proposal be revised to require that any prospective student who fails the entrance test be referred for remedial instruction to available local education agencies or to proprietary schools that have opted to participate in, and have established, an approved counseling and remedial program.

Corrective Action: We agree that independent, third party ability-to-benefit testing would help to ensure that ability-to-benefit tests are properly administered. We included this proposal in the Secretary's default reduction legislation submitted to Congress. This provision has been enacted in Public Law 101-508, the Omnibus Budget Reconciliation Act of 1990.

OIG Recommendation #2: Recommend that the present system be restructured to provide prorated disbursements during the duration of the enrollment period, with the final disbursement made upon the successful completion of the training.

Corrective Action: Requiring institutions to prorate disbursements during the duration of the enrollment period with the final disbursement to be made upon the successful completion of the training is impractical as students will need these funds to pay for the period of enrollment for which these funds were granted. Many educational expenses must be paid up front, and students need to have their financial aid funds available to help cover these expenses. Although this requirement may aid in default reduction, it is unrealistic to expect Federal student financial aid to be used as a retroactive form of payment.

OIG Recommendation #3: Recommend that institutions applying to participate in student financial aid programs be required to disclose the basis for tuition charges.

Corrective Action: The Department does not concur with this recommendation. We do examine the financial situation of each instituion that applies for certification and eligibility to participate in the Department's programs. Furthermore, an institution is required to disclose the full cost of its educational program to prospective students. We fail to see any purpose served by collecting annual financial data (salaries, contract costs, etc.) which constitute the basis for an institution's pricing decisions.

OIG Recommendation #4: Recommend that the Office of the Assistant Secretary of Postsecondary Education coordinate with the Office of the Inspector General to revise the Student Financial Assistance Audit guide to require an audit to disclose prospective student information, e.g., completion rates, placement rates, etc.

Corrective Action: Page II-12 of the March 1990 Audit Guide includes the requirement that an audit disclose to prospective students information relative to completion rates, placement rates, etc. The Student Right-to-Know and Campus Security Act signed by the President on November 8, 1990 suspended the consumer disclosure requirements until July 1, 1993.

OIG Management Improvement Report (MIR) 90-06, "Improving the Department's Oversight of Secondary Markets," February 14, 1990

OIG Recommendation: OIG recommends that ED establish a system of oversight of all secondary markets participating in the GSLP.

Corrective Action: OPE developed a procedure whereby DAPR will track and control all GSL Audits to ensure submission of required audits. The GSL NPRM will propose that a lender whose outstanding loan portfolio during any fiscal year exceeds $50 million must have an annual audit. The Department is developing a proposed regulation that would require a guarantee agency to perform a biennial Program Review of each State or private nonprofit secondary market.

OIG Management Improvement Report (MIR) 90-07, "Standards Needed to Strengthen GA Lender Reviews," February 14, 1990

OIG Recommendation: OIG recommends that ED: 1. Modify the requirements for GA lender reviews to require periodic audits of participating loan lenders with 100 largest outstanding portfolios, 2. Issue an audit guide which sets forth the minimum procedures necessary to perform a lender audit, 3. Establish minimum standards in each of the standard areas applicable to GA lender reviews, and 4. Revise the lender review guide to improve the comparability and usefulness of the lender review reports.

Corrective Action: The Department is developing a proposed regulation that would require a lender whose outstanding GSL loan portfolio during any fiscal year exceeds $10 million must have an annual independent financial and compliance audit of its billings. The audit will focus primarily on a lender's interest benefits and special allowance billings. The auditor must examine other areas of the lender's operation as well, in order to determine the accuracy of those billings. In conjunction with this requirement, the OIG will be expected to issue an audit guide setting forth the minimum procedures necessary to perform a lender audit.

OIG Management Improvement Report (MIR) 90-08, "Weaknesses in Disbursing Loan Checks Directly To Borrowers," February 14, 1990

OIG Recommendation: OIG recommends that the PLUS loan program regulations be revised to require that PLUS loan checks be: 1. Sent directly to the school listed on the loan application and separate notification of disbursement sent to the borrower, and 2. Made co-payable to the borrower and school listed on the loan application.

Corrective Action: The Department does not concur with the recommendation that the GSL programs regulations be revised to require PLUS loan checks be co-payable and sent to the school the student attends. The Secretary is prohibited from requiring co-payable loan checks (Section 428(b)(b)(n) of the Higher Education Act of 1965). The Department is not persuaded that the number of abuses related to direct disbursement to the borrower justifies the significant burden that would result to borrowers if PLUS loan checks were sent directly to schools. OPE believes the Department should continue to enforce the fraud and abuse penalties against those few criminal borrowers rather than add an enormous administrative burden on schools and the possibility of forcing the student's parent(s) to travel to the school to receive the PLUS loan check. The Department will continue to explore procedures designed to ensure that only eligible borrowers receive loans under the PLUS program.

OIG Management Improvement Report (MIR) 90-09, "Extensive Non-Compliance By Certain Lenders With the Department of Education's Due Diligence Requirements," February 14, 1990

OIG Recommendation: The OIG recommends that ED (1) take immediate action, perhaps through a "Dear Colleague" letter, to communicate to all GA's and lenders the problems with Electronic Data Processing (EDP) controls and lack of adequately trained staffs; and (2) require GA's and lenders to take immediate steps to address these problems.

Corrective Action: OPE does not agree with this recommendation, which does not specifically address problems related to the GSL program.

OIG Management Improvement Report (MIR) 90-10, "Proposed Procedures To Ensure Payment Of Loan Origination Fees for Stafford Loans," February 14, 1990

OIG Recommendation: OIG recommends that the OPE: 1. Require that all lenders return the pre-printed interest billing forms (Forms 799) each quarter whether or not they have interest and special allowances to claim or origination fees to report; 2. Monitor the return of pre-printed Forms 799 to confirm that all reports are received; and 3. Take prompt action to obtain the required reports from lenders who have not submitted them.

Corrective Action: The Department agrees that it is possible for a lender to fail to pay origination fees to the Secretary. This possibility arises when the originating lender sells the loans shortly after they are made. The Department is developing a proposed regulation that would address the rule currently found in CFR 682.304(a)(4). OPE will also publish a "Dear Colleague" Letter informing purchasing lenders that they are responsible for payment of the origination fee if the selling lender does not pay it. In addition, we have several administrative activities that are designed to ensure payment of origination fees:

1. A deactivation notice is sent to a lender that does not submit an ED Form 799 for four quarters. (Note: Under current law, a lender is not required to submit a Form 799). When we send the deactivation notice we also request that the lender submit any unpaid origination fees; 2. We now identify candidates for lender reviews by assigning points for late filing of 799 forms; 3. Special computer software identifies under-reported origination fees by a lender who does file a Form 799.

The Department believes that the above actions will protect the Federal Government's interests. Therefore, we do not believe it would be cost effective to implement the recommendations contained in this report. The Department further believes these actions will more effectively target those lenders most likely to under report origination fees.

OIG Management Improvement Report (MIR) 90-11, "Improving the Supplemental Loans For Students (SLS) Program," February 14, 1990

OIG Recommendation: OIG recommends that ED ascertain provisions which will ensure that the SLS program is administered properly by proprietary schools. Accordingly, OIG recommends that ED assure that these provisions be included and enacted in the HEA reauthorization bill.

Corrective Actions: The Department does not agree with the general recommendation made by the OIG; however, OPE has agreed to continue to examine a wide range of SLS eligibility issues for participating schools. OPE is studying the issues for reauthorization. The Department's reauthorization proposal is expected to be submitted in early 1991.

OIG Management Improvement Report (MIR) 90-12, "Controls Needed Over the Use of Third Party Servicers in the GSLP," February 14, 1990

OIG Recommendation: OIG recommends that ED: 1. Revise the GSLP regulations to require servicer audits in the agreements between guarantee agencies and lenders. All lenders which choose to use servicers should obtain an annual audit of compliance with GSLP regulations from the servicer. The audit should be performed by a CPA in accordance with Government Auditing Standards, issued by the Comptroller General of the United States, and an audit guide prepared by ED; 2. Issue an audit guide which sets forth the minimum procedures necessary to perform the servicer compliance audit. The guide should consider the needs of all potential users including: ED, loan holders, GA's and servicers; 3. Require that the reports be submitted to ED and subjected to desk review and quality control procedures similar to audits of schools participating in the SFA programs; and 4. Require that users including ED, loan holders, GA's and servicers have access to the audit working papers.

Corrective Action: The Department does not concur with the recommendations made in this report. The holder of a GSL loan that contracts with a servicer is responsible for compliance with applicable program laws and regulations. The Secretary regulates the activities of lenders and GA's and specifies audits and reviews of those entities to ensure compliance. In our view, since the holder of the loan is held responsible for any failure of its agent, there is no need to regulate the activities of the agent. The Department is developing a proposed regulation to address the collection procedure to be used by GA's in collecting defaulted loans.

OIG Management Improvement Report (MIR) 90-13, "Unrestricted Branching is Detrimental to Students and Taxpayers," February 20, 1990

OIG Recommendation #1: ED should apply the two-year rule to branch campuses.

Corrective Action: The Department is developing a proposed regulation to address the "two-year rule" for branch campuses.

OIG Recommendation #2: ED should consider requesting legislative authority for the Secretary to regulate branch campuses that participate in the SFA programs. Areas that may need to be regulated are the number of branches, proximity of main campuses and branch campuses, similarity of programs, and acceptance of interim accreditation without a site visit.

Corrective Action: On October 31, 1990, the Department developed a NPRM which would address the issue on the Secretary's ability to regulate branch campuses that participate in SFA programs.

OIG Recommendation #3: ED should consider whether schools that add branch campuses need to be recertified.

Corrective Action: DEC has agreed to develop expanded certification activities to include recertification of an institution that adds branch campuses.

OIG Management Improvement Report (MIR) 90-14, "Inequitable Clock to Credit Hour Conversions Harmful to Students and Taxpayers," February 21, 1990

OIG Recommendation #1: Before approving any conversion requests, ED should verify compliance with the equivalencies and as needed, request justification for any variances. In conjunction with this ED should emphasize to the educational community that credit hours assigned to clock hour programs should not exceed academic year equivalencies established by SFA regulations. In summary, ED should approve conversions, and all affected parties should be so advised.

Corrective Action: The Department developed a Notice of Proposed Rule-Making (NPRM) which establishes an equivalent relationships between clock hours and credit hours by occupational, vocational, trade, and technical programs for purposes of receiving Title IV funds under the Student Financial Assistance Programs (SFAP). The package was published in the Federal Register in September 1990.

The Eligibility Branches of OPE have been scrutinizing conversion requests and requiring additional information of the states, accrediting agencies, or institutions in cases where the conversions or supporting documentation appear questionable.

OIG Recommendation #2: ED should consider expanding institutional program reviews to include determination of whether converted program equivalencies are in accordance with the regulations.

Corrective Action: The Department developed a Notice of Proposed Rule-Making (NPRM) which establishes an equivalent relationships between clock hours and credit hours by occupational, vocational, trade, and technical programs for purposes of receiving Title IV funds under the Student Financial Assistance Programs (SFAP). The package was published in the Federal Register in September 1990.

The Eligibility Branches of OPE have been scrutinizing conversion requests and requiring additional information of the states, accrediting agencies, or institutions in cases where the conversions or supporting documentation appear questionable.

OIG Draft Audit ACN 11-90040, "Institutional Eligibility Process Does Not Provide Adequate Assurance that Only Eligible Schools Participate in the Title IV Programs," July 26, 1990

Response: This draft audit is under review and consideration by the Department.

OIG Draft Audit ACN 11-90050, "Accrediting Agency Recognition Process Does Not Determine That all Recognized Agencies are Reliable Authorities on the Quality of Educational Services," July 27, 1990

Response: This draft audit is under review and consideration by the Department.

OIG Final Audit ACN 01-70090, "GSL Holders Should be Required to Provide Data on Refunds and Cancellations Which Could be Used to Systematically Identify Schools with Potential Refund Problems," August 18, 1990

OIG Recommendation: OIG recommends that ED require:

(1) GSL loan holders to routinely gather account data necessary to determine propriety and timeliness of refunds and returns of disbursements (cancellations) and periodically provide that information to the appropriate Guarantee Agencies (GA); and (2) GAs to relay that data to the Department.

Corrective Action: While the Department does not take issue with the findings of this final report, we do not concur with the recommended action. ED believes that the action as described would be more costly than the projected savings, and that the data collection burden would be excessive, particularly as it affects both loan holders and guarantors. It is our experience that schools with histories of non-payment or delinquent payment of refunds generally are deficient in other program areas as well. Therefore, we believe that we are likely to be selecting those schools for institutional review. We are not convinced that the cost incurred to gather and process the additional data involved in this recommendation would result in the direct annual savings described, as we are already reviewing schools for refund and cancellation liabilities. When violations are identified, we require prompt payment of delinquent refunds and frequently impose fines for failure to comply with program requirements.

OIG Draft Audit ACN 11-00012, "Administrative Certification Process Does Not Assure that Schools are Capable of Administrating Title IV Funds," August 31. 1990

Response: The draft audit is under review and consideration by the Department.

Senate Permanent Subcommittee
on Investigations

EXHIBIT # 3

TO: Ms. Patricia Hobson
Director
Division of Field Operations

FROM: Mr. Douglas A. Parrott - Chicago V
Chief, IRB

SUBJECT: Weekly Report for Week Ending September 28, 1990

I. Current Week's Prograr/Decision Act

A. Significant Achievements - None

B. Significant Problems - None to

C. Decisions Needed/Taken - None t

II. ITEMS OF SPECIAL INTEREST

TRAINING OFFICERS REPORT

--More--

DATE: September 17-21, 1990
LOCATION: Chicago, Illinois
TOPIC: Pre-Certification Training
AUDIENCE: FAA, CEO
NO. PARTICIPANTS: 105
PRESNETERS: D. Cattin, F. Reeves, J. Zink,
B. Hageman, E. Voulgarakis,
L. Coffey, B. Johnson,
D. Heath, B. Wanzek and
D. Van Riper
(Robert Wanzek - FTS 353-0375)

IRB/OSLB REPORT

UPDATE: National Technical College

The accrediting aguncies for both the National Technical College, Chicago, Illinois and the National Technical College, North Hollywood, Calif. have withdrawn the accreditation of those institutions. This region has obtained copies of the letters notifying the institutions. The

--More--

Illinois State Board of Education has alerted the Regional Office that Anatoly Bidnev has purchased the Chandler Schools, Grand Rapids, Michigan, a currently eligible institution, has renamed the school Westwood Schools, Inc., and has moved it to Chicago. Westwood will offer the same courses as National Technical College and an additional course, Private Security. Apparently NATTS has already approved these transactions. The Illinois

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State Board of Education will grant authority to Westwood to do business in Illinois. Obviously, an application from Westwood will soon be in DEC.

A change has already cleared DEC for Westwood Educational at the same address as National Technical College in Detroit, Michigan.
(David H. Heath - FTS: 353-0375)

Chicago Institute of Technology (CIT)

Ed and Earl Ciaglias, owners of CIT, were informed by the Accrediting Bureau of Health Education Schools (ABHES) that the agency voted to withdraw

--More--

ABHES accreditation of the school. CIT has the right to appeal the decision. Several months ago, OSFA initiated termination action against the school and placed CIT under the reimbursement method of payment, based on violations uncovered during a program review.
(Douglas A. Parrott - FTS 353-0375)

GAO School Closure Interview

The General Accounting Office has requested that the IRBC provide oral responses to questions concerning our regions experience with Perkins Loan portfolios at schools that close. This examination should occur in the next few weeks.
(Douglas A. Parrott - FTS 353-0375)

Schools on Reimbursement

The following schools were placed on the reimbursement system of payment this week:

Adrian Beauty Academy

--More--

Adrian, Michigan

Detroit Institute of Commerce
Detroit, Michigan

Michigan Paraprofessional Training Institute
Oak Park, Michigan

Debbie's School of Beauty Culture - Chain
Chicago, Illinois (headquarters)
Locations throughout the U.S.

School Closures

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Senate Permanent Subcommittee
on Investigations

EXHIBIT # 4

ISSUE: INSTITUTIONS OWNED BY ANATOLY BIDNY

BACKGROUND

On February 22, 1990, Anatoly Bidny purchased the Chandler School of Business and changed the name to Westwood Educational. Under Bidny's ownership, Westwood satisfies the statutory and regulatory definition of a proprietary institution of higher education as stated in the September 12, 1990, Department of Education (ED) Eligibility letter.

Before Westwood could actually participate in ED's student financial aid programs, ED conducted an analysis of the school's administrative and management capabilities. That analysis included the review of Dun & Bradstreet reports, default management and drop out data, outstanding financial liabilities owed to Ed, outstanding audit reviews, and student refund practices.

The results of that analysis did not reveal any bases upon which to deny the institution continued access to federal student financial aid programs. Therefore, on September 25, 1990, the institution was re-certified [under the new ownership] to participate in the programs.

On June 13, 1990, Bidny relocated Westwood [along with its students and faculty] to 144 West Lafayette, Suite 200, Detroit, Michigan 48226, the same address as the National Technical Institute (NTI), which is a separately eligible institution owned also by Bidny. In September 1990, ED approved the address change for Westwood (along with the approval for the ownership change and the name change from Chandler Schools). NTI is accredited by the Accrediting Bureau of Health Education Schools (ABHES). Westwood is accredited by the National Association of Trade and Technical Schools (NATTS). NTI offers totally different curriculum from that offered at Westwood.

In August 1990, Bidny contacted the agency that accredits NTI to initiate the approval by the agency for an address change for NTI. He advised the agency that he planned to move Westwood to the NTI site at 144 West Lafayette, Suite 200. On September 18, 1990, Bidny advised the accrediting agency that he wished to withdraw his request to change the location of NTI. [Note: Since Bidny withdrew his request to move the NTI school, ED is unaware of the proposed "new" location for NTI]. Consequently, two of Bidny's separately eligible institutions were then located physically at 144 West Lafayette, Suite 200, Detroit, Michigan 48226.

CURRENT STATUS

During ED's review of this case since October 1990, the Department discovered that both of the accrediting agencies have the respective institutions under review. We also discovered that on September 24, 1990, Bidny again relocated the Westwood school to 23077 Greenfield Road, LL29, Southfield, MI. That relocation has not been approved by the accrediting agency, nor has it been reported to ED.

ACTIONS BEING TAKEN

To follow up on telephone discussions with the relevant accrediting agencies, by letters dated January 4, 1991 (attached), the Department requested both ABHES and NATTS to confirm whether the Bidny-owned institutions are in compliance with the agencies' rules and procedures related to the common location of NTI and Westwood. Based upon those responses, along with an explanation from the owner (which the Department will request directly from the schools' owner subsequent to receiving responses from ABHES and NATTS), the Department will determine whether emergency actions are warranted to terminate the eligibility of each school.

In addition to the actions that are underway to determine whether grounds exist for emergency action, it should be noted that Accountability Initiative Regulations are being finalized by the Department. These regulations will give ED authority to prevent owners who have mismanaged Federal funds at a prior institution from gaining certification for Title IV participation at newly acquired institutions.

Attachments

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF POSTSECONDARY EDUCATION

January 4, 1991

Dorothy C. Fenwick, Ph.D.
Executive Director
National Association of Trade
  and Technical Schools
2251 Wisconsin Avenue, N. W.
Washington, D. C. 20007

Dear Dr. ~~Fenwick~~: Dorothy,

This is to request your assistance in confirming the institutional eligibility for Westwood Educational, 144 West LaFayette, Suite 200, Detroit, Michigan 48226.

Westwood is owned by Anatoly Bidny. You may be aware that Mr. Bidny also owns the National Technical Institute, which is accredited by the Accrediting Bureau of Health Education Schools (ABHES). NTI offers dental- and medical-related educational programs. Based upon applications filed with this office, Mr. Bidny represents that Westwood and NTI are located at the same address to include Suite 200.

Mr. Bidny purchased Westwood on February 20, 1990. It is our understanding that in August 1990, Mr. Bidny contacted ABHES to initiate ABHES approval for an address change for NTI. He advised ABHES that he planned to move Westwood to the NTI site. The Department of Education (ED) approved Westwood's change of ownership (name and address) on September 12, 1990. On September 18, 1990, we understand that Mr. Bidny advised ABHES that he wished to withdraw his request to change the location of NTI. Consequently, two of Bidny's institutions -- which are separately accredited and eligible -- are located physically at the same address.

We would appreciate a determination from you as to whether Westwood is in compliance with NATTS rules and procedures related to the common location of NTI and Westwood.

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202

Page 2 -- Dorothy C. Fenwick, Ph.D.

Your expeditious response is greatly appreciated. If you need further explanation, please feel free to call me at (202) 708-4913.

Sincerely,

Lois

Lois M. Moore, Chief
Division of Eligibility
and Certification

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF POSTSECONDARY EDUCATION

January 4, 1991

Ms. Jeanne Glankler
Administrator
Accrediting Bureau
of Health Education Schools
29089 U. S. 20 West
Elkhart, Indiana 46514-1198

Dear Ms. ~~Glankler~~: Jeanne,

This is to request your assistance in confirming the institutional eligibility for the National Technical Institute (NTI), 144 West Lafayette, Suite 200, Detroit Michigan.

NTI is owned by Anatoly Bidny. You may be aware that Mr. Bidny also owns Westwood Educational (Westwood), which is accredited by the National Association of Technical and Trade School (NATTS). Based upon applications filed with this office, Mr. Bidny represents that Westwood and NTI are located at the same address to include Suite 200.

Mr. Bidny purchased Westwood on February 20, 1990. Westwood offers a number of business-related educational programs. It is our understanding that in August 1990, Mr. Bidny contacted your agency to initiate ABHES approval for an address change for NTI. He advised ABHES that he planned to move Westwood to the NTI site. The Department of Education (ED) approved Westwood's change of ownership (name and address) on September 12, 1990. On September 18, 1990, we understand that Mr. Bidny advised ABHES that he wished to withdraw his request to change the location of NTI. Consequently, two of Bidny's institutions -- which are separately accredited and eligible -- are located physically at the same address.

We would appreciate a determination from you as to whether NTI is in compliance with ABHES rules and procedures related to the common location of NTI and Westwood.

400 MARYLAND AVE. SW WASHINGTON DC 20202

Page 2 -- Ms. Jeanne Glankler

Your expeditious response is greatly appreciated. If you need further explanation, please feel free to call me at (202) 708-4913.

Sincerely,

Lois
Lois M. Moore, Chief
Division of Eligibility
and Certification

UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202

09-12-90

Senate Permanent Subcommittee
on Investigations

EXHIBIT # 5

MR. ANATOLY BIDNY
OWNER/PRESIDENT
WESTWOOD EDUCATIONAL
144 W LAFAYETTE ST
DETROIT, MI 48226

INSTITUTIONAL ELIGIBILITY NOTICE

REINSTATEMENT OF ELIGIBILITY UNDER NEW OWNERSHIP—DATE OF OWNERSHIP CHANGE: 02-22-90. NAME & ADDRESS CHANGES: FORMERLY--CHANDLER SCHOOLS, 325 FULLER, NE, GRAND RAPIDS, MI DATES: 02-22-90 AND 06-13-90 RESPECTIVELY.

Eligibility Expiration date: September 21, 1993

Dear MR. BIDNY:

We are pleased to inform you that based upon the information included in your application (ED Form E40-34P), the Secretary of Education has determined that

WESTWOOD EDUCATIONAL

located at: 144 W LAFAYETTE ST, DETROIT, MI 48226

satisfies the definition of an eligible

Proprietary Institution of Higher Education (Section 481(b),HEA)
Vocational School (Section 435(c),HEA)

as set forth in the above noted sections of the Higher Education Act of 1965, as amended (HEA). For the purpose of this determination, the following educational programs constitute that part of the institution that satisfies the above definition(s)

CLERK TYPIST III (GSLP ONLY)
CLERK TYPIST II
CLERK TYPIST I
WORD PROCESSING/CONDENSED (GSLP ONLY)
ADMIN SECRETARY III
ADMIN SECRETARY II
ADMIN SECRETARY I
BOOKKEEPING II(GSLP ONLY)
BOOKKEEPING I
WORD PROCESSING V (GSLP ONLY)

WORD PROCESSING IV
WORD PROCESSING III
WORD PROCESSING II (GSLP ONLY)

This Eligibility also includes the following non-main campus locations and eligible educational programs:

OPE ID: 02533702 BRANCH CAMPUS LOCATION (FORMERLY AN EXTENSION FACILITY)
205 NORTH MAIN, MT. PLEASANT, MI 48858

SAME EDUCATIONAL PROGRAMS AS MAIN CAMPUS

02533703 BRANCH CAMPUS (FORMERLY: 114 S. MAIN, ITHACA, MI 48847
2 FOUNTAIN PL, 60 N. DIVISION,NE, GRAND RAPIDS, MI 49503

SAME EDUCATIONAL PROGRAMS AS MAIN CAMPUS

Thus, for this designation, the institution is the sum of the above-listed educational programs.

As a result of the designation as an eligible institution, the institution is eligible to apply to participate in the following postsecondary education Federal assistance programs administered by the U.S. Department of Education -

- Higher Education Act of 1965, as amended:

  Title IV: Part A - Students Attending Institutions of Higher Education
  Subpart 1 - Pell Grants
  Subpart 2 - Supplemental Educational Opportunity Grants
  Subpart 4 - Special Programs for Students from Disadvantaged Backgrounds:
  - Talent Search
  - Upward Bound
  - Student Support Services
  - Educational Opportunity Centers
  - Staff Development Activities

  Part B - Guaranteed Student Loan Program
  Part C - Work-Study Program
  Part E - Perkins Loan Program

- Vocational Education Act:
  Title I: Vocational Education Assistance to States

This eligibility designation remains in effect so long as the Institution continues to satisfy all relevant statutory and regulatory eligibility requirements and the enclosed Requirements for Maintaining Institutional Eligibility, which are incorporated into this Notice by this reference.

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If you have any questions concerning the information included in this Notice or the enclosed Requirements for Maintaining Institutional Eligibility, please contact the Eligibility Branch of the Division of Eligibility and Certification.

Sincerely,

Lois M. Moore, Chief
Occupational/Vocational
Eligibility Branch
Division of Eligibility
and Certification

Eligibility Data:
Main Campus OPE ID: 02533700
Entity Number: 1954257222A1
Eligibility effective: ********
Academic Calendar: Clock Hours
Control: 3
Institution Type: 2
Accreditation: NATTS

Enclosure
Incorporated Requirements

AJJ

Senate Permanent Subcommittee
on Investigations

EXHIBIT # 6

UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

Honorable Sam Nunn
Chairman
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate
Washington, DC 20510

Dear Senator Nunn:

Enclosed are answers to the questions you provided to the Department following Secretary Cavazos' October appearance before the Subcommittee. We appreciate the opportunity to reflect on the Department's efforts to improve student loan program administration and to eliminate program abuses.

Sincerely,

Ted Sanders

Enclosure

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-0500

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1. Last month, the General Accounting Office testified that they have been unable to audit the guaranteed student loan insurance fund because of "the poor condition of the financial records" at the Department. The law (20 USC 1082 (b) (2)) states:

"The Secretary shall...maintain with respect to insurance under this part an integral set of accounts and prepare financial statement in accordance with generally accepted accounting principles, which shall be audited annually by the General Accounting Office..."

The Congress cannot expect the GAO to audit books and records that are not properly maintained. GAO has never been able to audit this account. What have you done to rectify this situation?

A. GAO is currently surveying the system in preparation for an audit. Though GAO testified that the system could not be audited in the past, they have not attempted to audit the system since 1985. Since their last attempt to audit, we have automated the majority of our accounting processes in order to facilitate an audit.

2. With the Sallie Mae solution to the HEAF situation, will any new guarantee agencies be created in the former HEAF states?

IF SO, will these new guarantors operate under a five year honeymoon period during which they are guaranteed 100% federal reimbursement, regardless of default rate?

IF SO, doesn't this solution merely send a signal that if a guarantor overextends itself, that the Department will march in, close the guarantor down, and have someone pick up the pieces at taxpayer expense?

The Department was responsible for putting the Sallie Mae/HEAF initiative together and believes that it is an effective and efficient way to solve HEAF's problems, keeping in mind the taxpayers' interests as the ultimate insurer of the student loan program. You are quoted in a September 28, 1990 press release as saying,

"The solution announced today meets the principles we stated when we first assessed HEAF's financial condition: namely, to stabilize the GSL program, assure students, their families and schools of continued access to loans; avoid a recurrence of the problems causing HEAF's financial difficulties; and keep costs to the taxpayer to a minimum."

A. The Department is designating a guarantee agency to operate as the designated guarantor, in each of the States in which HEAF is currently the designated guarantor, for an interim period of one year. Long-term designations will be made after the completion of that one-year period. It is possible that new guarantee agencies will be created in one or more of these States. However, the Department will closely evaluate the financial and programmatic capability of any such agency before designating it as a guarantor.

Unless a new guarantee agency agrees otherwise, it is entitled under 428(c)(7) of the Higher Education Act of 1965 to receive 100 percent reinsurance from ED for the first 5 years in which it guarantees loans. It is not yet clear whether any new agencies will be created as a result of HEAF's problems or whether those agencies will receive 100 percent reinsurance.

Two States have advised the Department that they wish to explore the possibility of creating a new non profit guarantee agency. The Department has conveyed to these States its strong preference that any new guarantee agency be State-sponsored, have the State's full faith and credit behind it, and waive the five-year moratorium on reinsurance reductions based on default rates.

The Department does not believe that the Sallie Mae solution to the HEAF situation sends the message that the taxpayer will bear the expense of a solution. The Sallie Mae solution limits the potential financial risk to the taxpayer and provides a significant financial incentive for Sallie Mae to ensure that the solution is implemented at the lowest possible cost. The other most likely outcomes would have resulted in a risk of greater costs in the future.

3. Under the HEAF solution plan, the $9 billion HEAF portfolio will be distributed between several other guarantee agencies over three years. I assume the other guarantors will readily take over HEAF's four-year college loans. Will you require these guarantors to also take a share of the proprietary paper as well?

A. The agreement between the Department, Sallie Mae and the Sallie Mae subsidiary that is operating as the Guarantor Servicer requires the Guarantor Servicer to develop a plan for the complete distribution of the HEAF portfolio. It is the Guarantor Servicer's obligation to develop a plan to distribute all of HEAF's outstanding guarantees. We anticipate that the plan will result in the distribution of guarantees of both four-year and proprietary school student loans to each guarantee agency.

During discussions with the Department and Sallie Mae, guarantee agencies have indicated a willingness to accept guarantees of loans to proprietary school students as part of their participation in the guarantee distribution plan. We expect that these agencies will cooperate with Sallie Mae in effecting the distribution of the complete HEAF portfolio.

4. HEAF, because of the high default proprietary loans they had guaranteed, was being reimbursed for only 80% of its claims. Under the solution you have reached with Sallie Mae, will not the taxpayer end up paying 100 percent on all of the HEAF loans over the next three years?

IF SO, Then what did we save by mandating the dissolution of HEAF? Under this plan, don't we end up spending more than we would have if we would have placed HEAF itself on a 100 percent reimbursement plan, especially when you consider the fees to be paid to Sallie Mae, and the costs involved in any new guarantee agency operations created?

A. It is possible that the Department may end up paying 100 percent reinsurance on loans currently insured by HEAF. However, under the distribution plan it is also possible that ED may pay less than 100 percent reinsurance on some of the loans. We should also note that, in the last few years, HEAF has been reimbursed for an average of 89% of its claims in each fiscal year. It is possible that the Department would have paid 100 percent reinsurance to HEAF under the statutory triggers in any event, had HEAF (1) remained in existence and secured financing to carry its loans to the following fiscal year before submitting them for reinsurance; or (2) filed for bankruptcy, in which case such financing might have been secured by the trustee.

Keeping HEAF in business by paying 100 percent would have been inconsistent with the statutory purpose to discipline guarantors with high default rates and would have been of questionable legality. Such action might also have put the Department in the position of being required to provide more funds to HEAF to protect the Department's investment. The Sallie Mae solution provides a cap on the risk to the taxpayer that would not exist if the Department had simply provided 100 percent reinsurance to HEAF. Had the Department kept HEAF in business by paying 100 percent reinsurance, HEAF would have continued to be dependent on continuing financing by a third party to meet its cash requirements. If that credit were cut off, the Government at that point would have to pursue solutions such as that involved here, but at substantially increased cost to the Government, or face a collapse of HEAF.

5. HEAF maintains it has turned its portfolio mix around, and would have had its financial woes corrected in two years. Did you investigate this claim? Is it accurate? Provide a copy of the Department's analysis of HEAF finances.

A. The Department completed an extensive analysis of HEAF's portfolio mix and the trends that would affect that mix. The Department also hired Kidder Peabody and Co. to undertake an analysis of HEAF's portfolio mix and financial condition. Based on those reviews, the Department concluded that HEAF's portfolio mix would change in the next two years. However, the financial analysis, and the information provided by HEAF to ED, indicated that, because HEAF would have a significant negative reserve at the end of the two year period, it would be unlikely to survive without a substantial infusion of funds, from the Department or another source.
A copy of the Department's analysis of HEAF's portfolio is attached.

Comparison of Two HEAF Baseline "Do-Nothing" Scenarios

	Baseline Scenario A Claims Submitted When Received Lenders Finance HEAF Deficits				Baseline Scenario B Claims Carried for 100% Reinsurance Lenders Finance HEAF Deficits and Carried Claims				
FY	(1) Claims Paid by ED	(2) Default Recov.	Net Cost to ED	(3) Lender "Out-of Pocket"	(4) Claims Paid by ED	(2) Default Recov.	Net Cost to ED	(3) Lender "Out-of Pocket"	ED Costs A vs. B
1991	(698,064)	69,668	(628,396)	0	(356,707)	71,338	(285,369)	0	(343,027)
1992	(357,352)	78,073	(279,279)	0	(372,778)	79,743	(293,035)	0	13,756
1993	(246,639)	83,874	(162,765)	0	(370,882)	85,544	(285,338)	0	122,573
1994	(122,956)	86,766	(36,190)	0	(358,550)	88,436	(270,114)	0	233,924
1995	(56,575)	88,097	31,522	0	(72,337)	89,766	17,429	0	14,093
1996	(26,814)	88,727	61,913	254,261	(26,814)	90,397	63,583	261,280	(1,670)
Total (Gross)	(1,508,400)	495,205	(1,013,195)	254,261	(1,558,068)	505,224	(1,052,844)	261,280	39,649
PV @ 8%	(1,294,295)	377,670	(916,625)	160,228	(1,273,973)	385,390	(888,583)	164,651	(28,041)
PV @10%	(1,249,484)	354,921	(894,563)	143,524	(1,215,955)	362,194	(853,761)	147,486	(40,802)
PV @12%	(1,207,531)	334,225	(873,306)	128,817	(1,162,147)	341,090	(821,057)	132,373	(52,249)

(1) Claims are submitted when received, and are paid at trigger percentages.
First year adjustment for the $67 million owed to ED is not reflected in these numbers.

(2) ED receives complement % of gross recoveries on all HEAF defaulted loans.

(3) Lenders finance all operating deficits through 1996. Costs include $30 million of annual operating expenses, collections costs (25%), unreimbursed claims, interest on the debt (at 10%), and only revenues are collections net of ED's portion. Lenders' "Out of Pocket" is outstanding HEAF indebtedness at end of FY'96.

(4) Claims are submitted only to 5% level; all over 5% are carried to next year.
First year adjustment for the $67 million owed to ED is not reflected in these numbers.

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"Baseline" Scenario - Cost to ED, HEAF Remains in Business

	"Ongoing Entity" Scenario				
FY	(1) Claims Paid by ED	(2) Reinsur. Premiums	(3) Admin. Cost Allow.	(4) Default Recov.	Net Cost
1991	(724,176)	5,000	(10,000)	70,279	(658,897)
1992	(510,723)	5,000	(10,000)	82,211	(433,512)
1993	(481,188)	2,500	(10,000)	93,526	(395,162)
1994	(390,990)	2,500	(10,000)	102,722	(295,768)
1995	(341,161)	2,500	(10,000)	110,746	(237,915)
1996	(285,711)	2,500	(10,000)	117,466	(175,745)
	(2,733,949)	20,000	(60,000)	576,950	(2,196,999)
PV @8%	(2,190,003)	16,015	(46,229)	434,699	(1,785,517)
PV @10%	(2,082,113)	15,227	(43,553)	407,332	(1,703,106)
PV @12%	(1,983,046)	14,504	(41,114)	382,491	(1,627,166)

Footnotes:

(1) Claims are submitted when received, and are paid at trigger percentages.
First year adjustment for the $67 million owed to ED is not reflected in these numbers.

(2) At .25% or .5%, proportioned for period of time HEAF exceeds 5%.
Assumes $1 billion of annual new originations ($650mm 4yr/$350mm prop).

(3) 1% on $1 billion of annual originations.

(4) HEAF receives complement % of gross default recoveries (recov%=24%; recov/yr=14%).

HEAF FINANCIAL STATEMENTS

GUARANTY SUMMARY REPORT

(In Thousands)

BASELINE "DO NOTHING" SCENARIO B

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

24% Recoveries

	FY'91 Outstg	FY'91 Defaults	FY'92 Outstg	FY'92 Defaults	FY'93 Outstg	FY'93 Defaults	FY'94 Outstg	FY'94 Defaults	FY'95 Outstg	FY'95 Defaults	FY'96 Outstg	FY'96 Defaults
Total Portfolio												
Total Loans	8,222,719		7,774,986		7,417,635		7,170,996		5,225,749		4,212,183	
In Repay	7,134,141		7,455,565		7,417,635		7,170,996		5,225,749		4,212,183	
In-Year Lender Claims		447,733		357,352		248,630		122,956		56,575		26,814
Carried Claims		300,000		391,026		375,599		251,356		15,762		0
Gross Claims		747,733		748,377		622,238		374,312		72,337		26,814
Default %		10.5%		10.0%		8.4%		5.2%		1.4%		0.6%
Claims Eligible @100%		356,707		372,778		370,882		358,550		72,337		26,814
Total Claims Paid by ED		358,707		372,778		370,882		358,550		72,337		26,814
Carried Claims		391,026		375,599		251,356		15,762		0		0
Default Recoveries (Gross)												
Through 1989		61,891		61,891		61,891		61,891		61,891		61,891
1990		26,880		26,880		26,880		26,880		26,880		26,880
1991		25,124		25,124		25,124		25,124		25,124		25,124
1992		0		12,007		12,007		12,007		12,007		12,007
1993		0		0		8,287		8,287		8,287		8,287
1994		0		0		0		4,131		4,131		4,131
1995		0		0		0		0		1,901		1,301
1996		0		0		0		0		0		901
Gross Revenues		113,895		125,902		134,189		138,320		140,221		141,122
Net to HEAF @EII Rate		42,557		46,159		48,645		49,885		50,455		50,725
To Education		71,338		79,743		85,544		88,436		89,766		90,397
Collections Costs		28,474		31,476		33,547		34,580		35,055		35,281
Net Revenues		14,083		14,684		15,098		15,305		15,400		15,445
Interest Expense		24,449		26,887		22,411		16,055		19,063		22,429
Operating Expenses		30,000		30,000		30,000		30,000		30,000		30,000
Reimbursement Shortfall		0		0		0		0		0		0
Net Excess/(Shortfall)		(40,365)		(42,204)		(37,313)		(30,750)		(33,663)		(36,985)
Additional Borrowings		40,365		42,204		37,313		30,750		33,663		36,985
"Warehousing" Borrowings		391,026		375,599		251,356		15,762		0		0
Cumulative Borrowings		80,365		122,569		159,881		190,631		224,295		261,280
Lender "Out of Pocket" Unpaid Debt		0		0		0		0		0		261,280

HEAF FINANCIAL STATEMENTS

GUARANTY SUMMARY REPORT

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

24% Recoveries

MANAGED LIQUIDATION

	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
Total Portfolio												
Total Loans	8,222,719		7,774,986		7,417,635		7,170,896		5,225,749		4,212,183	
In Repay	7,134,141		7,455,565		7,417,635		7,170,896		5,225,749		4,212,183	
Carried Claims		300,000										
Gross Claims		747,733		357,352		248,639		122,958		56,575		26,814
Default %		10.5%		4.8%		3.3%		1.7%		1.1%		0.6%
Total Claims Paid by ED		747,733		357,352		248,639		122,958		56,575		26,814
HEAF Claims Cost		0		0		0		0		0		0
Default Recoveries (Gross):												
Through 1989		61,891		61,891		61,891		61,891		61,891		61,891
1990		26,880		26,880		26,880		26,880		26,880		26,880
1991		25,124		25,124		25,124		25,124		25,124		25,124
1992		0		12,007		12,007		12,007		12,007		12,007
1993		0		0		8,267		8,267		8,237		8,267
1994		0		0		0		4,131		4,131		4,131
1995		0		0		0		0		1,901		1,901
1996		0		0		0		0		0		901
Gross Revenues		113,895		125,902		134,189		138,320		140,221		141,122
Less:												
Collections Costs		28,474		31,478		33,547		34,580		35,055		35,281
Unreinsured Claims		0		0		0		0		0		0
Interest Expense		2,000		2,000		2,000		2,000		2,000		2,000
Operating Expenses		30,000		30,000		30,000		30,000		30,000		30,000
Management Fee		5,000		5,000		5,000		0		0		0
Total Expenses		65,474		68,478		70,547		66,580		67,055		67,281
Net to Fund		48,421		57,427		63,642		71,740		73,166		73,842
Cumulative to Fund		48,421		105,848		169,490		241,230		314,396		388,238

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HEAF GUARANTY PORTFOLIO PROJECTIONS

4-YEAR COLLEGE LOANS

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

24% Recoveries

"STATIC" PORTFOLIO RUN-OFF

Rpmt Yr.	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
4-YEAR COLLEGE - CURRENTLY IN REPAYMENT												
11	0	0	0	0	0	0	0	0	0	0	0	0
10	0	0	0	0	0	0	0	0	0	0	0	0
9	0	0	0	0	0	0	0	0	0	0	0	0
8	0	0	0	0	0	0	0	0	0	0	0	0
7	0	0	0	0	0	0	0	0	0	0	0	0
6	0	0	0	0	0	0	0	0	0	0	0	0
5	0	0	0	0	0	0	0	0	0	0	0	0
4	1,368,231	6,687	1,381,543	4,451	1,357,093	0	1,357,093	0	0	0	0	0
3	484,533	3,926	480,607	2,349	478,258	1,563	476,694	0	476,694	0	0	0
2	532,120	5,991	526,128	4,263	521,866	2,551	519,315	1,698	517,617	0	517,617	0
1	563,005	14,247	548,758	6,179	542,580	4,396	538,164	2,630	535,553	1,751	533,803	0
0	387,669	18,796	368,873	9,334	359,538	4,048	355,490	2,860	352,610	1,723	350,886	1,147
4-YEAR COLLEGE - DEFERRED AND IN-SCHOOL												
(1)	760,137	11,517	748,620	36,297	712,323	18,026	694,298	7,817	686,480	5,562	660,918	3,328
(2)	573,687	0	573,687	8,692	564,995	27,394	537,601	13,604	523,997	5,900	518,097	4,198
(3)	319,421	0	319,421	0	319,421	4,840	314,582	15,252	299,329	7,575	291,755	3,205
(4)	0	0	0	0	0	0	0	0	0	0	0	0
(5)	0	0	0	0	0	0	0	0	0	0	0	0
TOTAL	4,988,803	61,165	4,927,638	71,565	4,856,073	62,817	4,793,256	43,862	3,392,281	22,511	2,893,077	11,958

HEAF GUARANTY PORTFOLIO PROJECTIONS
2-YEAR COLLEGE LOANS
(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

24% Recoveries

"STATIC" PORTFOLIO RUN-OFF

Rpmt Yr.	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
2-YEAR COLLEGE - CURRENTLY IN REPAYMENT												
11	0	0	0	0	0	0	0	0	0	0	0	0
10	0	0	0	0	0	0	0	0	0	0	0	0
9	0	0	0	0	0	0	0	0	0	0	0	0
8	0	0	0	0	0	0	0	0	0	0	0	0
7	0	0	0	0	0	0	0	0	0	0	0	0
6	0	0	0	0	0	0	0	0	0	0	0	0
5	0	0	0	0	0	0	0	0	0	0	0	0
4	215,042	3,238	211,804	1,611	210,194	0	210,194	0	75,194	0	0	0
3	78,827	1,898	76,929	1,158	75,770	576	75,194	0	76,377	0	76,377	0
2	83,070	3,004	80,066	1,928	78,138	1,177	76,962	585	63,073	480	62,593	0
1	73,386	5,307	68,079	2,462	65,617	1,580	64,037	964	38,062	573	37,489	285
0	51,407	7,789	43,618	3,154	40,464	1,463	39,001	939				
2-YEAR COLLEGE - DEFERRED AND IN SCHOOL												
(1)	117,076	3,548	113,528	17,201	96,327	6,966	89,361	3,231	86,130	2,074	84,056	1,266
(2)	29,999	0	29,999	909	29,090	4,408	24,682	1,785	22,897	828	22,069	531
(3)	0	0	0	0	0	0	0	0	0	0	0	0
(4)	0	0	0	0	0	0	0	0	0	0	0	0
(5)	0	0	0	0	0	0	0	0	0	0	0	0
TOTAL	648,807	24,784	624,024	28,423	595,600	16,169	579,431	7,505	361,732	3,955	282,584	2,082

HEAF GUARANTY PORTFOLIO PROJECTIONS

PROPRIETARY SCHOOL LOANS

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

24% Recoveries

"STATIC" PORTFOLIO RUN-OFF

Rpmt Yr.	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
PROPRIETARY SCHOOL - CURRENTLY IN REPAYMENT												
11	0	0	0	0	0	0	0	0	0	0	0	0
10	0	0	0	0	0	0	0	0	0	0	0	0
9	0	0	0	0	0	0	0	0	0	0	0	0
8	0	0	0	0	0	0	0	0	0	0	0	0
7	0	0	0	0	0	0	0	0	0	0	0	0
6	0	0	0	0	0	0	0	0	0	0	0	0
5	0	0	0	0	0	0	0	0	0	0	0	0
4	275,510	12,698	262,813	7,808	255,005	0	255,005	0	0	0	0	0
3	471,315	33,636	437,679	20,172	417,507	12,404	405,103	0	405,103	0	479,565	0
2	629,884	71,937	557,947	39,818	518,128	23,880	494,249	14,684	479,565	0	271,459	0
1	453,420	96,872	356,548	40,720	315,828	22,539	293,288	13,517	279,771	8,312	124,316	0
0	328,332	126,856	201,477	43,045	158,432	18,094	140,338	10,015	130,322	6,006	95,813	3,693
PROPRIETARY SCHOOL - DEFERRED AND IN SCHOOL												
(1)	261,177	19,786	241,391	93,265	148,126	31,647	116,479	13,303	103,177	7,363	65,368	4,416
(2)	165,471	0	165,471	12,536	152,935	59,089	93,846	20,050	73,796	8,428	0	4,665
(3)	0	0	0	0	0	0	0	0	0	0	0	0
(4)	0	0	0	0	0	0	0	0	0	0	0	0
(5)	0	0	0	0	0	0	0	0	0	0	0	0
TOTAL	2,585,109	361,785	2,223,324	257,364	1,965,961	167,652	1,798,309	71,569	1,471,735	30,109	1,036,522	12,774

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HEAF FINANCIAL STATEMENTS

GUARANTY SUMMARY REPORT

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

24% Recoveries

"ONGOING ENTITY" SCENARIO

	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
In Repayment	7,484,141		8,778,048		9,579,773		10,098,341		8,885,060		7,586,907	
Carried Claims		300,000										
Gross Claims		774,248		518,698		481,432		390,990		341,161		205,711
Default %		10.3%		5.9%		5.0%		3.9%		3.8%		3.8%
Claims Eligible @100%		374,207		438,952		478,989		390,990		341,161		205,711
Claims Eligible @90%		268,429		71,771		2,199		0		0		0
Claims Eligible @80%		80,540		0		0		0		0		0
Total Claims Paid by ED		724,176		510,723		481,188		390,990		341,161		205,711
HEAF Claims Cost		50,072		7,975		244		0		0		0
Default Recoveries (Gross)												
Through 1989		61,891		61,891		61,891		61,891		61,891		61,891
1990		26,880		26,880		26,880		26,880		26,880		26,880
1991		26,015		26,015		26,015		26,015		26,015		26,015
1992		0		17,428		17,428		17,428		17,428		17,428
1993		0		0		16,176		16,176		16,176		16,176
1994		0		0		0		13,137		13,137		13,137
1995		0		0		0		0		11,463		11,463
1996		0		0		0		0		0		9,600
Gross Revenues		114,786		132,214		148,390		161,528		172,991		182,590
Net to HEAF @EH Rate		44,507		50,003		54,864		58,805		62,244		65,124
To Education		70,279		82,211		93,526		102,722		110,746		117,466
Less												
Collections Costs		28,636		33,054		37,098		40,382		43,248		45,648
Uninsured Claims		50,072		7,975		244		0		0		0
Interest Expense		4,000		4,000		4,000		4,000		4,000		4,000
Operating Expenses		30,000		30,000		30,000		30,000		30,000		30,000
Management Fee		0		0		0		0		0		0
Total Expenses		112,708		75,029		71,342		74,382		77,248		79,648

HEAF GUARANTY PORTFOLIO PROJECTIONS

4-YEAR COLLEGE LOANS

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

24% Recoveries

"ONGOING ENTITY" SCENARIO

Rpmt Yr.	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
4-YEAR COLLEGE - CURRENTLY IN REPAYMENT												
11	0	0	0	0	0	0	0	0	0	0	0	0
10	0	0	0	0	0	0	0	0	0	0	0	0
9	0	0	0	0	0	0	0	0	0	0	0	0
8	0	0	0	0	0	0	0	0	0	0	0	0
7	0	0	0	0	0	0	0	0	0	0	0	0
6	0	0	0	0	0	0	0	0	0	0	0	0
5	0	0	0	0	0	0	0	0	0	0	0	0
4	1,368,231	6,687	1,361,543	4,451	1,357,093	0	1,357,093	0	0	0	0	0
3	484,533	3,926	480,607	2,349	478,258	1,563	476,694	0	476,694	0	0	0
2	532,120	5,991	526,128	4,263	521,866	2,551	519,315	1,698	517,617	0	517,617	0
1	563,005	14,247	548,758	6,179	542,580	4,396	538,184	2,630	535,553	1,751	533,803	0
0	387,669	18,796	368,873	9,334	359,538	4,048	355,490	2,880	352,610	1,723	350,886	1,147
4-YEAR COLLEGE - DEFERRED AND IN-SCHOOL												
(1)	760,137	11,517	748,620	36,297	712,323	18,026	694,298	7,817	686,480	5,562	680,918	3,328
(2)	1,223,687	0	1,223,687	18,541	1,205,147	58,431	1,146,715	29,018	1,117,697	12,584	1,105,113	8,954
(3)	969,421	0	969,421	0	969,421	14,688	954,733	46,290	908,443	22,988	885,455	9,969
(4)	650,000	0	650,000	0	650,000	0	650,000	9,848	640,152	31,038	609,114	15,414
(5)	650,000	0	650,000	0	650,000	0	650,000	0	650,000	9,848	640,152	31,038
TOTAL	7,588,803	61,165	7,527,638	81,413	7,446,225	103,703	7,342,522	100,182	5,885,247	85,495	5,323,058	69,850

HEAF GUARANTY PORTFOLIO PROJECTIONS

2-YEAR COLLEGE LOANS

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

24% Recoveries

"ONGOING ENTITY" SCENARIO

Rpmt Yr.	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
2-YEAR COLLEGE - CURRENTLY IN REPAYMENT												
11	0	0	0	0	0	0	0	0	0	0	0	0
10	0	0	0	0	0	0	0	0	0	0	0	0
9	0	0	0	0	0	0	0	0	0	0	0	0
8	0	0	0	0	0	0	0	0	0	0	0	0
7	0	0	0	0	0	0	0	0	0	0	0	0
6	0	0	0	0	0	0	0	0	0	0	0	0
5	0	0	0	0	0	0	0	0	0	0	0	0
4	215,042	3,238	211,804	1,611	210,194	0	210,194	0	0	0	0	0
3	78,827	1,898	76,929	1,158	75,770	576	75,194	0	75,194	0	0	0
2	83,070	3,004	80,066	1,928	78,138	1,177	76,962	585	76,377	0	76,377	0
1	73,386	5,307	68,079	2,462	65,617	1,580	64,037	964	63,073	480	62,593	0
0	51,407	7,789	43,618	3,154	40,464	1,463	39,001	939	38,062	573	37,489	285
2-YEAR COLLEGE - DEFERRED AND IN SCHOOL												
(1)	117,076	3,548	113,528	17,201	96,327	6,966	89,361	3,231	86,130	2,074	84,056	1,266
(2)	29,999	0	29,999	909	29,090	4,408	24,682	1,785	22,897	828	22,069	531
(3)	0	0	0	0	0	0	0	0	0	0	0	0
(4)	0	0	0	0	0	0	0	0	0	0	0	0
(5)	0	0	0	0	0	0	0	0	0	0	0	0
TOTAL	648,807	24,784	624,024	28,423	595,600	16,169	579,431	7,505	361,732	3,955	282,584	2,082

HEAF GUARANTY PORTFOLIO PROJECTIONS

PROPRIETARY SCHOOL LOANS

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

24% Recoveries

"ONGOING ENTITY" SCENARIO

Rpmt Yr.	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
PROPRIETARY SCHOOL - CURRENTLY IN REPAYMENT												
11	0	0	0	0	0	0	0	0	0	0	0	0
10	0	0	0	0	0	0	0	0	0	0	0	0
9	0	0	0	0	0	0	0	0	0	0	0	0
8	0	0	0	0	0	0	0	0	0	0	0	0
7	0	0	0	0	0	0	0	0	0	0	0	0
6	0	0	0	0	0	0	0	0	0	0	0	0
5	0	0	0	0	0	0	0	0	0	0	0	0
4	275,510	12,696	262,813	7,806	255,005	0	255,005	0	0	0	0	0
3	471,315	33,636	437,679	20,172	417,507	12,404	405,103	0	405,103	0	0	0
2	629,884	71,937	557,947	39,818	518,128	23,880	494,249	14,684	479,565	0	479,565	0
1	453,420	96,872	356,548	40,720	315,828	22,539	293,288	13,517	279,771	8,312	271,459	0
0	328,332	126,856	201,477	43,045	158,432	18,094	140,338	10,015	180,322	6,006	124,316	3,693
PROPRIETARY SCHOOL - DEFERRED AND IN SCHOOL												
(1)	611,177	48,301	564,876	218,247	346,628	74,056	272,572	31,130	241,442	17,231	224,212	10,334
(2)	515,471	0	515,471	39,051	476,420	184,071	292,349	62,459	229,889	26,255	203,634	14,533
(3)	350,000	0	350,000	0	350,000	26,515	323,485	124,983	198,502	42,409	156,093	17,827
(4)	350,000	0	350,000	0	350,000	0	350,000	26,515	323,485	124,983	198,502	42,409
(5)	350,000	0	350,000	0	350,000	0	350,000	0	350,000	26,515	323,485	124,983
TOTAL	4,335,109	388,300	3,946,809	408,862	3,537,948	361,559	3,176,388	283,303	2,688,081	251,711	1,981,266	213,778

HEAF FINANCIAL STATEMENTS

GUARANTY SUMMARY REPORT

(in Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

22% Recoveries

BASELINE "NO REFORM" SCENARIO

10% Deterioration

	FY'91 Outstg	FY'91 Defaults	FY'92 Outstg	FY'92 Defaults	FY'93 Outstg	FY'93 Defaults	FY'94 Outstg	FY'94 Defaults	FY'95 Outstg	FY'95 Defaults	FY'96 Outstg	FY'96 Defaults
Total Portfolio												
Total Loans	8,156,710		7,675,105		7,292,916		7,031,152		5,087,849		4,085,899	
In Repay	7,068,132		7,355,683		7,292,916		7,031,152		5,087,849		4,085,898	
Carried Claims		300,000										
Gross Claims		781,806		392,188		261,764		128,185		58,340		27,691
Default %		11.1%		5.2%		3.6%		1.8%		1.1%		0.7%
Claims Eligible @100%		353,407		367,704		261,764		128,185		58,340		27,691
Claims Eligible @90%		254,453		12,964		0		0		0		0
Claims Eligible @80%		116,378		0		0		0		0		0
Total Claims Paid by ED		724,238		380,748		261,764		128,185		58,340		27,691
HEAF Claims Cost		57,367		1,440		0		0		0		0
Default Recoveries (Gross)												
Through 1989		55,702		55,702		55,702		55,702		55,702		55,702
1990		24,192		24,192		24,192		24,192		24,192		24,192
1991		23,636		23,636		23,636		23,636		23,636		23,636
1992		0		11,557		11,557		11,557		11,557		11,557
1993		0		0		7,916		7,916		7,916		7,916
1994		0		0		0		3,876		3,876		3,876
1995		0		0		0		0		1,764		1,764
1996		0		0		0		0		0		637
Gross Revenues		103,530		115,087		123,003		126,879		128,643		129,481
Net to HEAF @ER Rate		40,655		44,166		46,540		47,703		48,232		48,484
To Education		62,875		70,922		76,463		79,176		80,411		80,997
Collections Costs		25,882		28,772		30,751		31,720		32,161		32,370
Net Revenues		14,772		15,394		15,789		15,983		16,072		16,113
Interest Expense		4,000		11,660		14,430		17,294		20,425		23,861
Operating Expenses		30,000		30,000		30,000		30,000		30,000		30,000
Reimbursement Shortfall		57,367		1,440		0		0		0		0
Net Excess/(Shortfall)		(76,595)		(27,706)		(28,641)		(31,311)		(34,354)		(37,747)
Additional Borrowings		76,595		27,706		28,641		31,311		34,354		37,747
Cumulative Borrowings		116,595		144,301		172,942		204,253		238,606		276,354
Lender "Out of Pocket" Unpaid Debt		0		0		0		0		0		276,354

HEAF FINANCIAL STATEMENTS

GUARANTY SUMMARY REPORT

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

19% Recoveries

BASELINE "DO NOTHING" SCENARIO A

20% Deterioration

	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
Total Portfolio												
Total Loans	8,090,702		7,577,205		7,171,900		6,896,403		4,955,946		3,965,834	
In Repay.	7,002,124		7,257,784		7,171,900		6,896,403		4,955,946		3,965,834	
Carried Claims		300,000										
Gross Claims		813,497		405,305		275,497		132,466		59,657		28,372
Default %		11.6%		5.6%		3.8%		1.9%		1.2%		0.7%
Claims Eligible @100%		350,106		362,889		275,497		132,466		59,657		28,372
Claims Eligible @90%		252,078		36,174		0		0		0		0
Claims Eligible @80%		148,644		0		0		0		0		0
Total Claims Paid by ED		748,827		401,063		275,497		132,466		59,657		28,372
HEAF Claims Cost		64,670		4,242		0		0		0		0
Default Recoveries (Gross):												
Through 1989		49,513		49,513		49,513		49,513		49,513		49,513
1990		21,504		21,504		21,504		21,504		21,504		21,504
1991		21,867		21,867		21,867		21,867		21,867		21,867
1992		0		10,895		10,895		10,895		10,895		10,895
1993		0		0		7,405		7,405		7,405		7,405
1994		0		0		0		3,561		3,561		3,561
1995		0		0		0		0		1,604		1,604
1996		0		0		0		0		0		763
Gross Revenues		92,884		103,778		111,184		114,744		116,348		117,111
Net to HEAF @Eff. Rate		36,821		40,203		42,425		43,493		43,974		44,203
To Education		56,063		63,575		68,759		71,251		72,374		72,908
Collections Costs		23,221		25,945		27,798		28,686		29,087		29,278
Net Revenues		13,600		14,259		14,629		14,807		14,887		14,925
Interest Expense		4,000		12,507		15,756		18,869		22,275		26,014
Operating Expenses		30,000		30,000		30,000		30,000		30,000		30,000
Reimbursement Shortfall		64,670		4,242		0		0		0		0
Net Excess/(Shortfall)		(85,070)		(32,490)		(31,127)		(34,062)		(37,388)		(41,088)
Additional Borrowings		85,070		32,490		31,127		34,062		37,388		41,088
Cumulative Borrowings		125,070		157,559		188,686		222,748		260,135		301,223
Lender "Out of Pocket":												
Unrepaid Debt		0		0		0		0		0		301,223

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HEAF FINANCIAL STATEMENTS

GUARANTY SUMMARY REPORT

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

22% Recoveries

BASELINE "DO-NOTHING" SCENARIO B

10% Deterioration

	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
Total Portfolio												
Total Loans	8,156,710		7,675,105		7,292,918		7,031,152		5,087,849		4,085,899	
In Repay	7,068,132		7,355,683		7,292,918		7,031,152		5,087,849		4,085,899	
In-Year Lender Claims		481,806		382,180		261,764		128,185		58,340		27,691
Carried Claims		300,000		428,199		442,603		339,721		116,348		0
Gross Claims		781,806		810,380		704,367		467,906		174,688		27,691
Default %		11.1%		11.0%		9.7%		6.7%		3.4%		0.7%
Claims Eligible @100%		353,407		367,784		364,646		351,558		174,688		27,691
Total Claims Paid by ED		353,407		367,784		364,646		351,558		174,688		27,691
Carried Claims		428,199		442,603		339,721		116,348		0		0
Default Recoveries (Gross)												
Through 1989		55,702		55,702		55,702		55,702		55,702		55,702
1990		24,192		24,192		24,192		24,192		24,192		24,192
1991		23,636		23,636		23,636		23,636		23,636		23,636
1992		0		11,557		11,557		11,557		11,557		11,557
1993		0		0		7,916		7,916		7,916		7,916
1994		0		0		0		3,876		3,876		3,876
1995		0		0		0		0		1,764		1,764
1996		0		0		0		0		0		837
Gross Revenues		103,530		115,087		123,003		126,879		128,643		129,481
Net to HEAF @Eff. Rate		38,609		42,076		44,451		45,613		46,143		46,394
To Education		64,921		73,011		78,552		81,266		82,501		83,087
Collections Costs		25,882		28,772		30,751		31,720		32,161		32,370
Net Revenues		12,726		13,304		13,700		13,894		13,982		14,024
Interest Expense		27,459		32,647		29,793		20,910		21,718		25,492
Operating Expenses		30,000		30,000		30,000		30,000		30,000		30,000
Reimbursement Shortfall		0		0		0		0		0		0
Net Excess/(Shortfall)		(44,732)		(49,343)		(46,093)		(37,016)		(37,736)		(41,468)
Additional Borrowings		44,732		49,343		46,093		37,016		37,736		41,468
"Warehousing" Borrowings		428,199		442,603		339,721		116,348		0		0
Cumulative Borrowings		84,732		134,075		180,168		217,184		254,920		296,389
Lender "Out of Pocket" Unrepaid Debt		0		0		0		0		0		296,389

HEAF FINANCIAL STATEMENTS

GUARANTY SUMMARY REPORT

(In Thousands)

BASE CASE SCENARIO - NATIONAL DEFAULT FREQUENCIES

10% Recoveries

BASELINE "DO-NOTHING" SCENARIO B

20% Deterioration

	FY'91 Outstg.	FY'91 Defaults	FY'92 Outstg.	FY'92 Defaults	FY'93 Outstg.	FY'93 Defaults	FY'94 Outstg.	FY'94 Defaults	FY'95 Outstg.	FY'95 Defaults	FY'96 Outstg.	FY'96 Defaults
Total Portfolio												
Total Loans	8,090,702		7,577,205		7,171,900		6,896,403		4,955,946		3,965,834	
In Repay	7,002,124		7,257,764		7,171,900		6,896,403		4,955,946		3,965,834	
In-Year Lender Claims		813,497		405,305		275,497		132,466		59,657		28,372
Carried Claims		300,000		463,391		505,806		422,708		210,354		22,214
Gross Claims		813,497		868,696		781,303		555,175		270,011		50,586
Default %		11.6%		12.0%		10.9%		8.1%		5.4%		1.3%
Claims Eligible @100%		350,108		362,889		358,595		344,820		247,797		50,586
Total Claims Paid by ED		350,108		362,889		358,595		344,820		247,797		50,586
Carried Claims		463,391		505,806		422,708		210,354		22,214		0
Default Recoveries (Gross):												
Through 1989		49,513		49,513		49,513		49,513		49,513		49,513
1990		21,504		21,504		21,504		21,504		21,504		21,504
1991		21,867		21,867		21,867		21,867		21,867		21,867
1992		0		10,895		10,895		10,895		10,895		10,895
1993		0		0		7,405		7,405		7,405		7,405
1994		0		0		0		3,561		3,561		3,561
1995		0		0		0		0		1,604		1,604
1996		0		0		0		0		0		763
Gross Revenues		92,884		103,778		111,184		114,744		116,348		117,111
Net to HEAF @Eff. Rate		34,576		37,844		40,068		41,134		41,615		41,844
To Education		58,308		65,934		71,118		73,610		74,733		75,267
Collections Costs		23,221		25,945		27,796		28,686		29,087		29,278
Net Revenues		11,355		11,900		12,270		12,448		12,528		12,564
Interest Expense		30,386		38,355		37,419		28,036		24,806		28,851
Operating Expenses		30,000		30,000		30,000		30,000		30,000		30,000
Reimbursement Shortfall		0		0		0		0		0		0
Net Excess(Shortfall)		(49,041)		(58,455)		(55,149)		(45,587)		(42,278)		(46,285)
Additional Borrowings		49,041		58,455		55,149		45,587		42,278		46,285
"Warehousing" Borrowings		463,391		505,806		422,708		210,354		22,214		0
Cumulative Borrowings		99,041		145,496		200,646		246,233		288,510		334,795
Lender "Out of Pocket": Unrepaid Debt		0		0		0		0		0		334,795

6. It is not at all clear that this is the best or most efficient solution to the HEAF situation. To the contrary, it seems that this solution may in fact end up costing the taxpayers even more than it would have taken to bail HEAF out of its financial problems. Please comment.

A. The Department has determined that the net cost of the Sallie Mae solution to the HEAF problem will be less than $30 million and will be the least expensive solution to the problem in the short and long terms.

A bail-out of HEAF, such as by paying 100 percent reinsurance on loans it currently insured, by the Department would have required the Department to provide approximately the same $30 million to HEAF, and with no guarantee that it would survive in the long term, given its heavy dependence on Sallie Mae credit and significant negative reserve position. Moreover, once the Department committed that money it would be required to provide any additional funds to HEAF that were needed in the near future, or risk HEAF's collapse within a few years. HEAF thus could have become a "black hole" absorbing unexpected amounts of Federal expenditures. In addition, a bail-out would have established a costly precedent if other guarantee agencies develop serious financial problems.

In contrast, the solution devised by the Department establishes a cap on both the amount of time and the amount of Federal funds that will be expended in the solution to the HEAF problem. It also promotes program stability by dispersing the HEAF portfolio among other guarantee agencies, rather than concentrating it in a single guarantee agency. The Department believes that any other solution would have continued many of the problems faced by HEAF and resulted in additional costs to the government and the taxpayers.

7. A state licensing official testified that a state circuit court judge ordered an accrediting body to grant "provisional accreditation" to the Business and Construction Academy," and "shall provide appropriate letter of accreditation to enable the school to qualify for participation in Title IV funds of the U.S. Department of Education." He testified that the Department is not appealing the case. Now I realize you cannot track all State court decisions, but you are now aware of this. Is your general counsel going to appeal this decision?

A. The Department cannot appeal this case, because the suit was brought against the accrediting agency, not the Department. We have no indication that the accrediting agency at any time objected to the Department about the order, or sought the assistance of the Department in this litigation. The question assumes that the Department should always support an accrediting agency in any suit challenging its actions, rather than just those suits that would seek to prevent the Department from honoring proper revocations of accreditation status. In some cases, such as those in which a school seeks to have the court bar the Department from taking action in reliance on a duly-conducted revocation of accreditation status on the ground that the school is in bankruptcy proceedings, the Department has filed briefs to support accrediting agency actions.

8. The subcommittee staff found that while some state licensing boards and accrediting bodies each conduct program reviews of participating schools, there is no mechanism within the Department to assure that the reviews are completed and received by the Department. Don't you think it would be useful for the Department to know what these outside bodies are finding? Why isn't the Department receiving copies of these reviews and assuring that information reaches the Regional offices?

A. The Department routinely receives notices from State agencies and accrediting associations concerning adverse actions against schools, such as revocation of licenses and loss of accreditation. As appropriate, the Department then acts to terminate the school's eligibility to participate in the student financial assistance programs. The regional offices are usually aware of these actions either from direct contact with State agencies, notice from central office, or notice of a school closing.

The Department is not always aware of these revocation actions before they become final. Schools generally have due process rights in cases of loss of license or accreditation. Consequently, some agencies have been reluctant to share information until an action becomes final. Also, in some cases, the reasons for loss of license or accreditation may be unrelated to student financial assistance program violations. In these cases, the Department would not be able to act upon the information provided until the action is final.

The Department has taken a number of steps to improve its coordination with State agencies and accrediting bodies. We conduct monthly teleconferences with all State agencies. These conferences provide a forum for the discussion of mutual and individual issues related to eligible and licensed institutions. We see significant improvement in communication, cooperation, and coordination between the States and the Department as well as within and among the several States.

As a direct result of these teleconferences, and at the invitation of the State agencies, there have been a number of coordinated program reviews of institutions conducted jointly by representatives of the State licensing agency, the guarantee agency, and the Department. Representatives of the Department meet frequently with accrediting agency representatives both informally and at regular meetings.

The Department is also expanding access to the OPE Institutional Data System, in a capacity that allows state licensing agencies to view certain information so they may have appropriate information in preparing for their institutional recognition reviews. We intend to do the same for the accrediting agencies and the guarantee agencies within one year.

9. Although guarantee agencies apparently do file their program reviews with the Department, several agency officials have complained that there is no mechanism or requirement for the guarantee agencies to notify either the Department or any other appropriate law enforcement agency if fraud is suspected. Do you think such a requirement would be useful? Does the Department have any plans to impose such a requirement?

A. The Guaranteed Student Loan regulations already contain this exact requirement in 34 CFR 682.410(c)(4)-(7). In addition, the Department's Office of Inspector General has had a toll-free number in use for several years that anyone can use to report suspected fraud. That number is 1-800-MIS-USED (1-800-647-8733).

10. We also have heard testimony that the Department is not making full use of the guarantee agency program reviews. Specifically, Department employees complained to the Subcommittee staff that the Department in Washington refuses to send copies of guarantee agency program reviews to the regional officers in the field. As a result, the regional offices have no way of knowing what, if any problems, may already have been identified in schools operating in their region. Please comment on what you will do to rectify this situation.

A. The reported testimony reflects a misunderstanding that may have occurred because reports were sent to Headquarters for control, coding, and evaluation, in an effort to relieve the regions of an additional workload. These activities caused some delay in releasing reports, but in no case, were the reports withheld from the regional offices.

Since 1987, reports have been sent to the regions soon after receipt. In addition, a headquarters/regional office work group has been working to better utilize the information presented in these agency reviews, and we have directed the agencies to send one copy of their reports directly to the regional offices. Therefore, the regions are receiving copies of the reports within days of their completion.

11. I am concerned by an apparent lack of credible inspection procedures in the program reviews conducted by the Department. For example, reviewers apparently routinely provide the school being reviewed with a listing of the student files they wish to analyze and permit the school's employees to pull the files. We received testimony that this allows unscrupulous schools such as the school we reviewed in Florida, to alter the records before the reviewer actually gets access to them. One Inspector General employee reported that a school he investigated actually had two sets of student records. What steps is the Department taking to ensure that the integrity of its reviews are not compromised by the actions of the schools under review?

A. Department of Education program reviewers do not allow a school to select the sample of student records to be reviewed. The school provides the reviewers with a listing of students from which the sample is drawn. Because time is limited and files that pertain to a student may be in several locations, reviewers typically ask the school's staff to physically pull the files. Reviewers are aware that some schools may attempt to correct deficiencies in files. Usually, such attempts to alter data are counterproductive for a school because they create inconsistencies in the data, and the Department's reviewers make a special effort to identify such inconsistencies. In addition, the reviewers demand that the files be provided in a timely manner. Any unusual delay in providing the files is cause for suspicion, and the reviewers will change their sample.

The reviewers take into consideration other documents that a school cannot alter, such as Pell Grant Student Payment Summary or Stafford Loan Student Confirmation Reports. These would also include documents, such as promisory notes, requiring original signatures. This requirement makes the maintenance of duplicate files much more difficult to achieve. The reviewers also examine records in the Business Office and the Registrar's Office. In addition, interviews are conducted with students and school employees to determine whether there are any inadequacies or whether there is cause to suspect misrepresentation.

The Department uses unannounced program reviews when a school's administration of the financial aid programs is questionable. Because an unannounced program review starts immediately after the school has been notified, there is little time for the school to alter its records. The criteria that the Department uses for selecting a school for an unannounced program review include, but are not limited to:

- complaints from students and school employees
- recommendations by the Office of the Inspector General
- negative reports from State agencies, accrediting agencies and adverse press articles
- allegations of fraud and abuse.

12. The Subcommittee staff also heard testimony that even when program reviews do uncover violations, the school is held liable only for the actual findings of that review, with usually no follow-up to determine whether additional violations exist. For example, if 50% of the files reviewed reflected failure to make refunds for students who had withdrawn, the school would normally be asked to make refunds only on the files reviewed, with no further follow-up. Why doesn't the Department require that a complete review of all financial aid files be done, at least when violations of a certain magnitude are uncovered?

A. When significant regulatory violations are found during program reviews or audits, the Department (ED) routinely requires schools, lenders, and guarantee agencies to conduct complete file reviews or to review statistically valid samples to determine error rates and resulting liabilities. An error or violation is considered significant if it occurs in more than ten percent of files in the sample reviewed. In such a case, we base the assessed liability to the school on a projection drawn from the percentage of items in the sample which were errors or violations. However, if an error or violation is found in ten percent or less of the sample's files, liabilities are assessed only for those specific items in the sample. ED usually requires the results of any statistical sample to be validated by an independent certified public accountant.

13. The Subcommittee heard testimony that communication among the Department's various regional offices is so poor that a school operating in one region can open a branch in another region without that region ever knowing it. What is being done to improve coordination among the various regional offices in this regard?

A\. It is unlikely that the situation described in the question could now occur because there are a number of ways in which information is shared between the Department's regional offices and Headquarters. First, each time an eligible institution or branch of an institution is certified to participate in the student financial aid programs, a copy of the letter generated by the action is forwarded to the appropriate regional office(s). Second, this institution's status is also reflected on the hard copy weekly report, which is distributed to each regional office. Third, the most current information concerning an institution, or part thereof, is reflected on the Institutional Data System (IDS), an automated information system that is accessible to regional office staff. (Additional training is planned to enhance the regional office staff's facility with this system.) Fourth, by early 1991, each regional office will have an updated printout listing the locations of all main and branch campus sites for schools in that region.

14. We were also told that even within the Department's headquarters here in Washington there is inadequate communication among offices that are in the same building. For example, the staff's investigation found a lack of adequate communication between the program review office and the certification office. Why aren't the Department's offices talking with one another?

A. In general, communication among offices in headquarters is fairly good, and we are taking steps to improve it. For example, we recently implemented a partial reorganization of the Office of Student Financial Assistance, and also set up a working group of high-level Department officials which regularly reviews and sets policy for important program management issues. These types of management initiatives serve to make communication within the Department more systematic and effective.

In response to the specific reference in the question, there are frequent communications between the Certification Branch and the Program Review Branch. In fact, Certification staff often accompany Program Review staff on site visits.

The Institutional Data System (IDS) was developed to include the various Branches of the Division of Audit and Program Review (DAPR), including the Program Review Branch. The Certification staff utilizes the school data contained on the IDS on all of its reviews. In fact, the Certification staff contacts the regional offices of Program Review to gain input during the certification process.

An institution can be removed from participation in the Student Financial Aid (SFA) programs, but it is entitled to due process as outlined in SFA regulations. The Certification Branch, during the course of its reviews, sometimes encounters institutions that do not meet the Department's standards for administrative and/or financial capability. If the institution is unable to correct the deficiencies, it is referred to the Program Compliance Branch of DAPR for administrative proceedings, which may include termination. The procedures for such referrals have been agreed on through discussions between DAPR and the Division of Eligibility and Certification.

Q. The Subcommittee staff found that even when the Department has information on a school, it was so scattered that it was unlikely that all of the information in the Department's possession would be considered in reviewing the school's activities. Although the Department maintains several separate files on each school participating in the program, there is no master file or cross index for this information. Separate files may be kept in such offices as Finance-Disbursement, Campus Based Funds, Pell, Certification, Eligibility, Audit Review, IG Audit, IG investigation, and Program Review. What steps is the Department taking to ensure that all of the information in its possession is utilized to the maximum extent possible?

A. While it is true that hard copy documents and master computer systems exist in different areas of the Department, significant progress has been made to incorporate key data for each eligible institution on the Institutional Data System (IDS). These data concern eligibility, certification, audits, program reviews, and funding levels under the Student Financial Aid and Higher Education programs. We are also considering linking cash draw-down information from the Office of Financial Management Services to the IDS for routine monitoring. We expect that, in the near future, guarantee agencies and state authorizing and licensing agencies will have the capability to view information and transmit messages on the IDS. This will enable ED offices and appropriate outside organizations with oversight responsibilities to have access to a broad range of information on participating institutions.

16. It is my understanding that the regulations implementing the 1981 Higher Education Reauthorization Act were not issued until 1986, shortly after Congress passed the 1986 Reauthorization Act. It is now 1990. When does the Department intend to issue regulations to implement the 1986 Act?

A. All regulations implementing the 1986 Higher Education Act reauthorization were published several years ago, except for regulations pertaining to the Guaranteed Student Loan programs (Stafford, PLUS, Supplemental Loans for Students, and Consolidation). A notice of proposed rulemaking for the Guaranteed Student Loan programs was published on November 20, 1990. Delays in issuing these regulations have not prevented the Department from implementing the 1986 Act through guidance to affected parties. Nevertheless, the Department has taken steps to ensure that no such delay in issuing regulations occurs in the future.

17. A former Department lender review officer testified that his staff had only three program officers and no travel funds to cover all of California, Arizona, Nevada, Hawaii, and the Trust Territories. He testified, "It was a paper drill, and we really couldn't do anything except work by writing letters to people, getting them on the telephone, trying to encourage them to do something...If you cannot be there and put your hands on the records and look at them you are not going to be able to do the job." Even more frustrating is his testimony that he notified both his regional administrator and headquarters of the state of his capabilities. Nothing was done to help. Have conditions for your field staff improved?

A. During the 1986-87 period to which the employee alludes, the Department's budget was severely affected by the Gramm-Rudman-Hollings Deficit Reduction Act and subsequent appropriations cutbacks. Among other cutbacks during this period, the Department had virtually no money for travel for reviews, except reviews in the regional office city.

The number of staff assigned to the regional office function for the geographic area referred to has not changed much since 1986-1987. Although the number has increased from 3 to 8 reviewers, the workload of the San Francisco region has been combined with that of the Seattle and Denver offices so the area of geographical responsibility has increased. Nonetheless, the extent of oversight has increased markedly. Since late 1986, guarantee agencies have been required to review their top 10 lenders and schools annually. The information from these reviews is provided to the regional office. A review of this guarantee agency review function has become a responsibility of the lender reviewers. Therefore, the lender reviewers are better informed and the absolute number of reviews has increased.

The travel budget has increased from nearly none in 1986-87 to $147,280 in 1988, $203,212 in 1989 and $353,884 in 1990. (These are national figures for lender reviews). In addition, we expect both staffing and travel funds to increase in 1991/92.

18. This same former employee testified about unscrupulous schools who cared little about the quality of education versus collecting loan money. He said that these schools "sold seats" and that the Department was very aware of what they were doing. I'll ask you the same question I asked him, why do you think a department in charge of education would sit here and let this go on - knowing it - without trying to do something about it?

A: The Department is not aware of a situation where it knew that a school violated program law, regulation, policy, or procedure and did nothing about it. We are very much concerned about schools failing to provide a quality education, but the Department is limited by statute in the extent of its direct control over the area of educational quality; see, e.g., 20 U.S.C. 1232a and 3403(b). The determination of the quality of education has always been primarily the responsibility of the accrediting agencies and States.

However, we are taking aggressive action to the fullest extent of our statutory authority to address this problem: we are carefully reviewing the policies of the accrediting bodies before re-approving them, working with State licensing bodies to encourage them to become more involved in overseeing the operation of schools, applying outcome measures to schools such as default, graduation, job placement and licensure rates, and providing students with information to assist them in making informed choices before enrolling in a particular school. In addition, on October 4, the Department suspended 14 for-profit trade schools, utilizing the emergency action regulations which were authorized in the Student Loan Reconciliation Amendments of 1989 (part of the Omnibus Budget Reconciliation Act of 1989, P.L. 101-239).

There is an important distinction between the determination of the quality of the educational program offered by a school and making a determination of the school's capability of administering Title IV student aid programs. In accordance with the general statutory allocation of roles and responsibilities, the Department has always relied on the States and the accrediting bodies to ensure quality of education. While this has worked in most cases, the abuses that have been identified led us to take a much greater role in this area.

19. What do you think of the idea of making Federal student loan funds contingent on meeting performance standards specifically designed for proprietary schools?

A. Although the Department has opposed the creation of a separate student aid program for proprietary schools, in regulations and proposed rulemakings published by the Department over the last several years, we have continually called for greater accountability through outcome measurements that are appropriate for short-term vocational training programs.

We strongly believe that students receiving Federal financial aid funds should attend high quality institutions. Although determinants of "quality" differ across educational programs, educational outcomes--for example, program completion and job placement rates--are good indicators of educational quality. Students need to know this kind of information about an institution so that they can make good decisions about where to enroll. Therefore, it is important not only for institutions to improve their educational outcomes, but also to make their record publicly available to prospective students.

Another important step in ensuring educational performance is to ensure that accrediting agencies and state licensing bodies are effectively performing their jobs. The performance of these two critical components in the "Triad" of ED program approval is vital to sound Federal financial aid programs.

20. What is your response to the suggestion that the Department stipulate that accreditation commission membership include at best a minority of member school owners and school officials, or exclude member school owners/officials entirely?

A. The suggestion that school owners should not be members of an accreditation commission is worthy of careful consideration. However, the term "officials" is unclear and could be subject to an over-inclusive interpretation. Commission membership for "corporate officers" raises serious concerns, since they have a direct financial stake in their institution, and might be induced to act favorably on another school's behalf with an expectation of similar treatment by their peers. However, it could be problematic if the term "official" were interpreted to include a faculty member, department head or similar level position in a school; we do not see a compelling reason why such individuals should be denied eligibility for commission membership on a visiting team.

21. What steps has the Department taken to improve its procedures to stop payments promptly on accounts of ineligible institutions? Similarly, has anything been done to assure that guarantee agencies are promptly notified when an institution loses its eligibility?

A. To eliminate the receipt of Federal funds by those institutions that no longer satisfy eligibility criteria, the Department provides "early alerts" by sending electronic mail (E-mail) messages or written memoranda to appropriate entities, including the Department's Financial Management Service (FMS), program funding offices, and regional offices. These actions are also included in the weekly list of departmental eligibility actions, which is distributed to the Department's Financial Management Service, program funding offices, and regional offices, and to guarantee agencies.

22. What is your response to the suggestion from one of our witnesses that PLUS loans should be made co-payable to parents and the school, to prevent parents from using the money for purposes unrelated to their son or daughter's education?

A. While we share your concern that parents should not be allowed to take advantage of the PLUS program by using the money for purposes unrelated to paying for their child's education, we do not agree with the recommendation that PLUS loans should be made co-payable to parents and the school the student attends. We are not persuaded that the number of abuses related to direct disbursement to the borrower justifies the significant burden that would result to borrowers and schools if PLUS loan checks were made copayable. We believe the Department should continue to enforce the fraud and abuse penalties against those borrowers who abuse the system, rather than add a significant administrative burden for schools and parents (possibly requiring parents to travel to the school to endorse the check).

In any event, it should be noted that, under current law, the Secretary is prohibited from requiring co-payable loan checks. See section 428(b)(1)(N) of the Higher Education Act of 1965.

23. Several witnesses suggested that all proprietary school courses should be based on clock-hour calculations only. What are your views on this point? Relatedly, what are your views on establishing uniform course-length guidelines for specific types of training programs? What about setting maximum amounts for tuition aid based on the type of training and the cost of comparable training elsewhere?

A. Consistent with statutory limitations on the Department of Education's authority to set curriculum standards, the Department has allowed institutions considerable flexibility in determining the length and intensity of course. Unfortunately, we recognize that this has led to clear abuses by some institutions and subsequent waste of student aid funds. For this reason, we recently published proposed regulations that would establish conversion ratios between clock hours and credit hours for use in determining aid eligibility. This would permit a standard measurement for judging the amount of training provided to a student in any undergraduate vocation training program. Congress recently extended the open comment period on the proposed regulations through January 1, 1991 (P.L. 101-589).

So-called "course-stretching" has been a blatant abuse by some institutions and has been costly both to the Federal government and to students who pay more for courses than they need to. However, we do not think that it is appropriate for the Federal government to establish course-length guidelines or maximum tuition for specific types of training programs. In addition, a maximum tuition scheme would ultimately benefit public institutions, which are able to offer lower tuitions due to their public subsidization. There are legitimate differences of opinion about how much training is required for certain occupations and many States set different minimum standards for obtaining licenses in those occupations. Course stretching goes far beyond these variations, however, and should not be allowed as the basis for qualifying for ED student financial assistance.

24. What steps has the Department taken to improve and more effectively enforce its administrative review capability and in connection with this, have you considered such ideas as increased site reviews for schools that present the greatest risk, increased overall monitoring, requiring that schools make public annual external audits and certified financial statements, and requiring that schools have public representatives on their governing boards?

A\. Since January, 1989, the Department's Office of Postsecondary Education (OPE) has implemented the following actions to improve our administrative and financial reviews:

- Developed more rigorous standards for review of fidelity bonds (reviewing deductible amounts to determine if financial condition will support possible loss);
- Increased the amount of surety posted by financially marginal institutions to better protect the Federal government and students;
- Performed an Institutional Data System (IDS) review of those institutions that are under special financial monitoring to determine deficiencies in compliance areas such as audit, program review (both internal and guarantee agency reviews), and default rates and to determine that appropriate action is taken to ensure compliance;
- Improved communication of adverse determinations to interested parties. Denials of certification are provided to the accrediting body of the institution;
- Established stricter requirements for the submission of institutional financial statements. The recently cleared application package will require at least two years of financial statements as part of the application process. In addition, credit reports from outside credit sources are being obtained for all financial analyses;
- Implemented pre-certification training in December, 1989. This requires personnel at all institutions to undergo training in the management of student aid programs prior to initial participation in these programs;

In addition, all applicants are now being required to meet all standards of administrative capability prior to certification rather than at a later date. For example, an institution must demonstrate, prior to certification, that its withdrawal rate is less than 33 percent rather than submit a plan to lower the rate.

Finally, we are considering changes in procedures that would include increased site visits prior to certification and renewals of eligibility and certification. We are also conducting systematic reviews of high volume, high default institutions.

Current law does not authorize the Department to require private institutions to have public representatives on their governing boards. Moreover, enforcing such a requirement would broadly extend the Federal government's reach since, in many cases, institutions are not incorporated and may be organized as partnerships or sole proprietorships.

25. What is your response to the suggestion that Title IV eligibility requirements be revised to limit the percentage of total income a school can derive from Federal student financial aid sources?

A. We are very concerned about institutions that rely heavily on Federal student aid--for example, 80 or 90 percent of all revenues. This may be an indication that such institutions may be setting their tuition as a function of the amount of Federal aid available and may be enticing students into their institutions in order to maximize their revenues. In these cases, educational quality may be low and students may be enticed into training programs from which they cannot benefit.

Nonetheless, limiting the percentage of income a school can derive from Federal student financial aid sources raises serious concerns. The purpose of financial aid is to promote educational opportunity for students, particularly those with demonstrated need. Limiting the percentage of income that a school can derive from Federal student aid sources could undermine this goal by essentially "punishing" those schools that serve students with large amounts of need. Such a policy could discourage institutions from admitting as many students who could not afford to attend without Federal financial aid.

26. The Washington Post reported last month that GAO had been asked to determine if there is a broad pattern of former Federal officials trading their knowledge of student aid programs, either for profits for their schools or bigger salaries for themselves, at the expense of students and taxpayers. What are your views on these revolving door charges, and have you found any evidence to substantiate the claim that such actions may be having an adverse impact on Federal student financial aid programs?

A. The Department is aware that a number of former Department employees have accepted positions with proprietary schools or organizations that represent those schools. We do not believe there is a "broad pattern" of this career move, nor are we aware that those former employees have acted to the detriment of students, or that their involvement in student financial aid matters on behalf of private parties has had an adverse impact on Federal student financial aid programs. Federal ethics laws enacted by the Congress establish a delicate balance between prohibiting conflicts of interest for employees who leave Federal service, and not unduly constraining such post-employment opportunities. Subject to specific prohibitions against a former employee's representational activities directed to the Department, it is generally legal for former employees to take employment in a field for which they were responsible in the Government and to benefit from their general knowledge of Government programs. We have no information that any former Department employees in the student aid programs have violated these laws. Each of them received ethics training from the Department, and some have received individual ethics counseling both prior to and subsequent to their departure from the Department. In addition, in light of abuses that reportedly occurred in the past at the Department of Housing and Urban Development, the Secretary has directed all Department employees not to give any special access or other favored treatment to former Department employees.

27. Has the Education Department allocated sufficient resources to the certification and eligibility processes? If not, how much and what other kinds of resources are needed?

A. In the past, there have been enough staff to manage the rather limited role of the Department in the certification and eligibility process. As we expand our oversight in this area, however, we will bring on more staff, and thus improve our operations and reduce the time between recertification reviews. For example, a 26 percent increase in staffing is anticipated for FY 1991 and we expect to address this issue again in FY 1992. If, in the future, additional resources are made available, staff would be added to the offices that manage the specific accreditation, certification, and eligibility activities. We are also considering internal reassignment of staff to these activities to improve our capabilities for conducting reviews in each activity.

28. How do you respond to the observation made by some that what is needed in the area of Title IV problems is not more rules and regulations, but more and better enforcement of those already on the books?

A. The Department needs to do both. Obviously, we need to do a better job of enforcing our current rules and regulations. However, new problems do develop, such as in the HEAF situation, and we need to be able to develop new rules and regulations to address these situations. In some instances, this will require congressional action to provide statutory authority for these regulatory steps.

29. The Inspector General testified that the Department of Education has no plan to enforce an eligibility status update requirement mandated by July 1, 1988 regulations and, further, that as of December, 1989, more than 4,500 institutions were overdue for redetermination. Why?

A. In FY 1988, the Department reviewed 405 updated applications for eligibility and renewal of eligibility. In FY 1989, this number increased to 532. In the first 10 months of FY 1990, the Department processed 914 such updates. The Department will continue its efforts to properly address the remaining backlog of eligibility updates as well as future scheduled updates.

34 CFR 600.10(d) requires an eligible institution to renew its designation of eligibility, including all its educational programs and all its locations, every four years. Using this four-year renewal as a yardstick, approximately 3,000 institutions, at this time, are required to renew their eligibility.

A plan has been developed that will, through the Institutional Data System, identify those institutions that require the four-year renewal. That plan, which has been partially implemented, requires staff to focus on those schools whose eligibility data are the most outdated. Currently, each staff person, as a part of his/her performance agreement, must renew the eligibility of at least 50 institutions during the current performance period. As more staff resources become available, the Department will be able to address an even larger part of the total renewal universe.

30. The Inspector General also testified that "ED management advised that they did not have the authority to take strong actions, such as termination, when schools did not sufficiently correct high withdrawal rates." Do you agree, and, if so, what should be done in response?

A. A school's withdrawal rate is of interest to the Department to the extent that it bears upon the school's participation in the Department's programs. Accordingly, the Department's regulations treat high withdrawal rates as an indication of a school's impaired capability to properly administer the student financial assistance programs. Department regulations provide that a school may be required to correct high withdrawal rates by taking specific "reasonable and appropriate measures;" the Department can terminate a school that fails to take these steps (See 34 CFR 668.15(e)). If these steps are taken, but are not successful, termination is not imposed.

However, Congress, as part of the "Student Right-To-Know Act" (P.L. 101-542), recently suspended until July 1993 the Department's regulations which had been in effect requiring institutional disclosure, to prospective students in vocational programs, of the withdrawal rate of the institution and other information that could help prospective students in deciding whether to enroll.

31. The Consumer Bankers Association testified that the Department is operating on "1970s computer technology," and that they would recommend hiring three computer systems experts to totally revamp the information management system. Are your systems, software, and data that bad?

A. The Guaranteed Student Loan (GSL) system uses current IBM hardware, custom-designed software using a current computer language, electronic processing, electronic funds transfer, current PC technology and software, a current data base management system, and a combination of both batch and interactive processing. All software, including the data base management system software, reflects the most current programs available. Since all these aspects of the system represent current computer technology, we fail to see the basis for the CBA's statement.

During the past three years, we have redesigned approximately 80% of the GSL system, including the system that processes interest benefits and special allowance payments to lenders, to respond to new requirements and to improve edits and controls. In fact, our redesigned Debt Collection system is considered to be one of the best collection systems in the Federal government, and is on a par with those of private industry.

32. In terms of your overall budget, what percentage is represented by the student aid program costs? As far as the size of your nationwide staff, where does this program rank in relation to other programs you must oversee?

A. Student aid program costs are 41% of the total FY 1991 appropriation for the Department.

Staffing in both headquarters and in the regions for student financial aid program oversight comprises approximately 25% of the Full Time Equivalent (FTE) personnel funded by the Department's Program Administration account. In comparison, other program offices and their percentage of the total Department's FTE are as follows:

Office	Percentage
Elementary & Secondary Education	6
Special Education & Rehabilitative Services	11
Vocational and Adult Education	3
Educational Research and Improvement	13

33. Under current rules, a school is not eligible to participate in student aid programs until it has been in existence for two years. However, branch campuses of existing schools are not held to this requirement. As a result, the Inspector General has found that schools "have used the branch campus route to rapidly expand beyond their administrative aid financial capability to properly control their programs and fulfill their responsibilities to students." What has been the Department's reasoning in not applying the two year rule to branch campuses? Does the Department intend to apply this rule to branch campuses in the future?

A. The Department's practice in managing its programs has traditionally been to utilize its regulatory authority in responding to documented, significant program abuses. Abuses are usually uncovered through audits, especially those conducted by the Inspector General, and program reviews. With the explosive growth of the proprietary sector in the mid-1980s, branch campusing emerged as a significant problem needing to be addressed. In response, we are developing a proposed regulation which would, upon implementation as a final rule, require that branch campuses of eligible institutions be in existence for two years before becoming eligible and certified to participate in the Title IV programs. This rule would also require former branch campuses to operate for two-years as free-standing institutions before obtaining independent eligibility and certification to participate in Title IV.

34. In testimony before the Subcommittee on February 20, 1990, the Inspector General noted that one school, which operated a barber school program with about 20 students was determined, on the basis of the operation of that school, to be financially and administratively capable to operate a masonry school in a major metropolitan area more than 300 miles away. What limitations, if any, are there on the geographic distance between a school and its branch campuses? What limitations, if any, are there on the program content of a school and its branch campuses?

A. The statute and regulations require that a school be legally authorized to offer a program of postsecondary education in the State in which the school is physically located, but are silent on the issue of the geographic proximity of branch campuses to the main campus. The Department is currently developing regulations to address the branch campus issue. It should be noted that most States subject local branch campuses of out-of-State schools to the same qualification and licensure requirements applicable to free-standing schools established in their jurisdictions.

The Department is limited by statute with respect to the extent to which we can exercise control over the content of educational programs offered by schools. In general, judgments about program content have been the responsibility of accrediting agencies and States. However, through our recognition of accrediting agencies, we exercise some influence over the agencies' activities. We have begun a series of visits to accrediting agencies (similar in some ways to program reviews conducted at schools) to examine their accreditation actions. Through this process, we will encourage accrediting activities that promote quality education and training.

The Secretary has also recently identified seven accrediting agencies that accredit institutions accounting for more than 30 percent of the $1.2 billion in defaulted loans from the 1988 cohort (see question 43 for greater detail). The Secretary directed the National Advisory Committee on Accreditation and Institutional Eligibility to expand its review of accrediting agency standards and activities, and specifically, to scrutinize these seven agencies. In addition, the Deputy Secretary, Dr. Ted Sanders, and Assistant Secretary for Postsecondary Education, Dr. Leonard Haynes, recently met with representatives of these accrediting agencies, and the Office of Postsecondary Education is currently conducting in-depth reviews of their standards and practices.

35. In his February testimony, the Inspector General noted one school, which opened 20 branch campuses between 1983 and 1986, and another school which opened 5 branch campuses in an 18-month period. Did this type of activity on the part ever raise any red flags as an effort to evade the two year rule? Does the Department currently keep track of the number of branches being operated by individual schools?

A. Yes. As a result of our efforts to improve the quality and utility of the Institutional Data System (IDS), we now have the capability to identify any branch campuses associated with each eligible institution. Furthermore, (since August 24, 1990) we no longer automatically certify new branches of currently eligible institutions for student aid program participation. Instead, a request to certify a new branch prompts a re-examination of the entire institution to determine if it has the financial resources and administrative capability to manage federal funds at a new branch. In other words, we are paying particular attention to the ability of the institution to meet the demands placed on its finances and administration by the establishment of a branch campus. The situation will be more completely addressed by the proposed branch campus regulations we are developing.

36. In 1984, the American Truck Driving School of Prairie Hill, Texas entered into a contract with St. Mary of the Plains College, a small Catholic College in Kansas, to conduct its truck driving instruction. In joining with this college, an ongoing Title IV participant, the truck driving school also became eligible for the funds, bypassing the two year requirement. Does this sort of union make sense to you? Should institutions be able to avoid the two year wait in this way?

A. Prior to 1988, the governing Institutional Eligibility regulations permitted written agreements between an eligible institution to provide education services by contracting for these services from another institution or organization. These regulations did not limit the amount of education that an ineligible institution could provide to a student enrolled in the eligible institution. The latter institution needed only to secure the approval of its accrediting agency for the contractual arrangement.

We have since revised these regulations, so that, under 34 CFR 600.9, the eligible institution may still enter into a written agreement with an ineligible institution, but the ineligible institution may provide only up to 25 percent of the educational program of a student enrolled in the eligible institution. With the approval of the eligible institution's accrediting body, the ineligible institution may provide more than 25 percent but not more than 50 percent of the educational program of a student enrolled in the eligible institution.

The branch campus regulations being developed by the Department would not allow an institution to waive the "two-year" rule by being a participant in this type of arrangement. Each institution seeking participation in Title IV programs would have to operate independent of student financial aid funds for two full years.

37. Many have suggested that the current triad system was designed for 4-year public/private colleges and is not appropriate for proprietary trade schools. They claim that the presence of an overriding profit motive, high incidence of abuse, and high default rates demand that proprietary schools be treated differently in the program--either through a separate system of regulation or by subjecting them to tighter rules written in the overall program. Do you agree? What, if any, changes do you intend to make in the Department's treatment of proprietary schools?

A. Federal student aid recipients include millions of students attending many different types of institutions and educational programs. Given the wide scope of the student aid programs, there are many important distinctions that can be made among institutions participating in the aid programs. In some cases, an appropriate distinction is the type of education offered. In other cases, a more useful distinction is institutional control--that is, whether an institution is public, private non profit, or proprietary. Still other distinctions can be made on the basis of institution size, loan volume, default rate, location, student population, etc.

The Department has not sought authority to regulate institutions based on whether they are public, private non profit, or proprietary. We believe the current regulatory system is preferable because it affords the Department the flexibility necessary to identify and deal with problems in the student aid program as they emerge. However, within this broad regulatory authority, we attempt to identify problem areas using performance indicators such as default rates, and by the type of instruction offered (short-term vocational training versus a "degree" track). Basing regulatory requirements on an institution's performance and the type of education it provides is more equitable and better targeted than simply categorizing institutions by their financial structure.

38. A number of State licensing agencies informed our staff that many proprietary schools encourage students to drop out of the programs after they have completed 50% of their classes since no refund is required after that point. What can be done to curtail this practice?

A. The best way to curtail this type of abuse is to continue to enforce strong default reduction strategies. Any school that "encourages" such dropping out by its students would find its default rate rapidly increasing since students who do not complete their programs are more likely to default. For the following reasons, such a school would find the future of its participation in Title IV programs placed in serious jeopardy.

A school with a high default rate (i.e., greater than 30 percent) is subject to the pro rata refund requirement provisions of the June 5, 1989 default reduction regulations for students who withdraw before completing one half of the course. This may lessen or offset the financial incentives for such a practice.

More importantly, beginning in 1991, the school would be subject to termination from all Title IV programs if its fiscal year default rate exceeds 60 percent (this rate is to be lowered to 40 percent in increments of 5 percent by 1995), or if the rate exceeds 40 percent and has not been reduced from the preceding year's default rate (See 34 CFR 668.15(b)(1)).

Also, under the recently signed Omnibus Budget Reconciliation Act of 1990, any school that has a cohort default rate of 35 percent or more over the last three fiscal years would be terminated from all the Guaranteed Student Loan programs.

39. We heard testimony that most states have very weak or minimal standards for licensing proprietary schools, and that their efforts are poorly funded, under-manned, and fragmented. What constructive proposals are you going to implement to either strengthen or eliminate this leg of the triad?

A. State licensing is an area where it is difficult for the Federal government to exercise direct influence. For many States, licensing has been primarily a process for recognizing the creation and legitimacy of new business entities and for ensuring that these businesses follow proper accounting and tax procedures. On the other hand, many States now also administer licensing examinations to students for certain kinds of training without necessarily accepting the view that the licensure should involve them in setting training standards or in becoming advocates for student consumer rights.

Under current law, the Department does not have authority to mandate licensing standards for States to adopt. However, there are several constructive initiatives we can implement to help States improve their licensing processes. The first is to provide more timely and detailed information to State agencies about the practices of schools that violate Federal student aid regulations. Too often, States have been unaware of our investigations or the results of our audits and program reviews. Second, we need to work more closely with States to forge a common view of how licensing standards can strengthen the triad and thus protect both taxpayers and consumers. Finally, we need to identify and publicize successful State efforts to increase the effectiveness of their licensing functions so that these efforts can serve as models for States that still have only minimal standards.

40. The Department was unable to provide the Subcommittee staff a list of State offices charged with licensing of schools participating in the student loan programs. Has the Department ever found it necessary to verify a school's license? Don't you think it would be useful for the Department to know who is responsible for licensing schools who are participating in Title IV programs?

A. As a part of its eligibility process, the Department is in continuous contact with State licensing agencies. A list of those agencies is attached.

In addition to routinely contacting the State agencies to verify school licensure, several months ago the Department began conducting monthly telephone conference meetings with 20 to 27 representatives of State higher education and vocational education authorizing and licensing agencies. During these telephone conferences, the Department advises the State officials of various policy and procedural changes, and the State officials advise the Department of changes in their licensing criteria. Additionally, information relating to specific institutions is also exchanged.

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41. The Subcommittee Staff was told by Department officials that the Department makes no attempt to monitor, oversee or influence State licensing procedures, citing a lack of jurisdiction to do so. What statutes prevent the Department from doing so?

A. Congress has made State licensing one of the requisites which an educational institution must meet in order to qualify for participation in Higher Education Act programs. However, the relevant statutes clearly authorize the Department merely to look to what the States have done in licensing particular institutions. The statutes provide no authority for the Department to direct the States or use them as its agents in their licensing activities. However, the Department is taking steps to improve sharing of information about problem schools among State licensing agencies, accrediting agencies, and the Department; and to persuade States to strengthen their licensing activities. In addition, as part of the Department's reauthorization effort, careful consideration will be given to possible legislative tools that the Department can use to ensure that the States properly discharge their licensing functions.

42. Are you familiar with the Veterans' Administration program for certifying school eligibility? Can you explain the difference between their program and ED's? Wouldn't it make sense to have one federal agency monitoring and controlling all student assistance whether under the Title IV or the GI bill or other programs? Would you accept such a recommendation to eliminate the duplication of efforts we now have?

A. There are, indeed, many differences between ED and VA student assistance programs, particularly in terms of their program approval processes. ED requires every potential participating institution to go through a three-step process of accreditation, State licensing, and ED certification, as specified in statute.

VA contracts with individual State approving agencies (SAAs) to approve courses for the enrollment of eligible students under veterans' education laws and has authority to deny approval of schools for benefit purposes which do not meet certain standards. Matters such as standards of academic progress and tuition refund policies, in addition to any approval criteria which the State may have adopted, are routinely examined during the approval process. While the VA does not require that eligible educational programs be accredited, SAAs are permitted to accept accreditation as the basis of program approval. To ensure that schools continue to meet approval criteria, SAAs and VA regional office personnel periodically review school activities.

Differences between VA and ED programs are based not only on different administrative and statutory eligibility procedures, but also on inherent differences in the types of aid offered and students served by each agency. Although there is undoubtedly some programmatic overlap, having a single federal agency monitor all student assistance would not eliminate differences between the two programs. A more constructive step towards reducing duplication of effort would entail closer cooperation and communication between VA and ED.

43. Federal regulations (34 CFR 602.13(g)) require recognized accrediting agencies to have a procedure for the timely review of complaints pertaining to institutional or program quality. However, a May, 1989 Inspector General memorandum on Accrediting Agency Complaint Procedures, noted that some accrediting agencies refused to accept responsibility for complaints, especially as they related to Title IV funding. In some cases, the accrediting agencies did not inform schools and students of the complaint procedure. What, if anything have you done to curb this practice that could be a violation of Federal regulations?

A. Current regulations governing recognition of accrediting agencies require agencies to have procedures for "the timely review of complaints pertaining to institutional or program quality, as these relate to the agency's criteria, in a manner that is fair and equitable to the person making the complaint and to the institutions or program." Such procedures must be maintained, made publicly available and be clearly written.

The Secretary's criteria for recognition do not explicitly require accrediting agencies to accept responsibility for Title IV compliance issues. However, we believe that accrediting agencies should pay closer attention to this. Earlier this fall, we identified 89 institutions - less than one percent of the Nation's 10,000 postsecondary institutions - which accounted for more than 30 percent of the $1.2 billion in defaulted loans from the 1988 cohort. Of these 89 institutions, 84 were accredited by the following seven of the 96 accrediting agencies recognized by the Department:

-- The Accrediting Bureau of Health Education Schools (ABHES);
-- The Accrediting Council for Continuing Education and Training (ACCET);
-- The Association of Independent Colleges and Schools, Accrediting Commission (AICS);
-- The National Accrediting Commission of Cosmetology Arts and Sciences (NACCAS);
-- The National Association of Trade and Technical Schools, Accrediting Commission (NATTS);
-- The National Home Study Council, Accrediting Council (NHSC);
-- Southern Association of Colleges and Schools, Commission on Occupational Education Institutions (SACS).

The Secretary directed the National Advisory Committee on Accreditation and Institutional Eligibility to expand its review of accrediting agency standards and activities, and specifically, to scrutinize these seven agencies. In addition, the Deputy Secretary, Dr. Ted Sanders, and Assistant Secretary for Postsecondary Education, Dr. Leonard Haynes, recently met with representatives of the accrediting agencies and discussed the dimensions and gravity of the default problem, and urged the agencies to prevent poor quality schools from being accredited, and to revoke the accreditation of poor quality schools which are already accredited.

44. In December, 1989 the Higher Education Act was amended to include a provision regarding the impact of an institution's loss of accreditation, particularly in instances where the school has dual accreditation. The statute, 20 USC 1085(n), states that an institution may not be certified or recertified (by the Department) as an eligible institution if its institutional accreditation has been terminated, either voluntarily under a show cause order, or for cause by the accrediting agency. How does the Department expect to monitor the adverse actions taken by accrediting agencies against member schools?

A. Current rules require an agency to notify the Secretary within 30 days of any final decision to withdraw accreditation (34 CFR 602.16(f)). If an agency misses the 30 day deadline or the Department learns that the agency failed to notify us of an accreditation withdrawal, the deficiency is noted and raised when the agency is under consideration for renewal of its recognition.

45. On a yearly basis, how many accrediting agencies apply to the Accrediting Agency Evaluation Branch for recognition by the Secretary and to be listed as a Nationally Recognized Accrediting Agency? Of those that apply for recognition, how many are accepted?

A. On average, we receive 3-4 petitions for initial recognition per year. The table below reflects the activity since 1968.

SUMMARY OF RECOGNITION ACTIONS

Applicants for Initial Recognition Since 1968	Approved Initially	Denied or Deferred and Later Recognized	Denied or Withdrawn - Never Recognized
80	34	17	29
	42.5%	21.25%	36.25%

46. How many of the recognized accrediting agencies have been de-recognized in the last 10 years?

A. In the last 10 years one accrediting body has been removed from the list of accrediting agencies recognized by the Secretary. Since the inception of the recognition process in 1952, eight agencies have been removed from the Secretary's list.

47. The Inspector General testified that the Accrediting Agency Evaluation Branch does little verification of information that is submitted in accrediting agency applications for initial recognition or renewal recognition. What steps have you taken or are you taking to make sure the AAEB considers all relevant information and that only agencies that assure quality education are listed as recognized by the Secretary?

A. The testimony of the Inspector General does not accurately portray the AAEB verification process. The Accrediting Agency Evaluation staff does an extensive and thorough analysis of all documents and materials submitted to the Secretary by accrediting bodies seeking initial or continued recognition by the Secretary. The agency is then contacted concerning any deficiencies in the written record that would be helpful in the review and decision concerning the petition. At the same time, the staff conducts on-site reviews of the accrediting body's processes and procedures to verify all information provided in the written record. Further, in the case of accrediting bodies that accredit trade schools, special attention is given to verifying the ways in which the accrediting agency assesses institutions' procedures and practices in such matters as admissions on the basis of ability-to-benefit, clock-credit hour conversions, course length, retention and graduation rates, and job placement experience.

It should be noted that, in the past, AAEB hesitated to rely too heavily on information in the Institutional Data System (IDS) which contained information of uncertain accuracy. The accuracy of the IDS has been greatly improved, and AAEB can now utilize the IDS with much greater confidence.

48. The Inspector General testified that 97% of schools applying to the Department of Education for Certification and Eligibility were approved for Title IV funds. Do you find this part of the triad to be an adequate filter for bad schools? Why, or why not?

A. The Inspector General may have been correct for previous years (1986-1989), but it is not an accurate picture of the Department's present activity.

Denials of certification have increased to 10-12 percent of applicants. This is a direct result of measures initiated by the Department. For example, schools are no longer approved on the basis of future submissions or anticipated accomplishments such as lowering withdrawal rates or improved financial conditions.

It is the Department's view that this part of the triad is an adequate filter for the review of applicants for student aid funding.

49. Our staff was told by officials from your Certification branch that even if they had been aware of many of the problems associated with the owners of one of the schools we looked at, the Culinary School of Washington, they couldn't have denied them certification to participate in the Title IV program. Does this make any sense? In this case, there was an audit by an independent CPA stating that one owner, Dr. Kibarian, had embezzled over $100,000 from Southeastern University where he was the President for the benefit of the Culinary School of Washington which he owned with his wife. Your staff knew nothing about this even though it was reported in the Washington Post. Your staff said even if they had, that would not have been grounds to bar them from participating in Title IV. Is this a problem? How do you propose we tighten up this system?

A. The case of the Culinary School of Washington is one that has been given a great deal of attention by the local media, your Subcommittee, the Department, including the Office of the Inspector General, the District of Columbia government, and the Accrediting Commission on Continuing Education and Training.

Apparently, the funds allegedly embezzled from Southeastern University were the school's own funds, not Title IV funds. One significant problem with using the allegation of Dr. Kibarian's embezzlement from Southeastern University to bar the Culinary School of Washington from participation in the Title IV student aid programs was that Southeastern University itself did not secure a conviction on which the Department would have relied; in fact, Southeastern University did not even prosecute this charge. The Department may have been able to use this allegation, either to debar Kibarian after 1988 under the debarment and suspension regulations promulgated at that time, or to try to argue that this was an adequate basis to find that the Culinary School of Washington lacked financial or administrative capability and limit the Kibarians' involvement with the school or terminate it from Title IV program participation entirely. However, to do this, the Department itself would have had to not only investigate, but actually prove the truth of the allegation of embezzlement from Southeastern University. Normally, due to staffing limitations and other considerations, the Department's investigations are limited to possible misuses of Federal funds.

In general, the items generally taken into account during the eligibility and certification determination of a proprietary institution include the following: accreditation by a nationally recognized commission, State licensure, existence for at least two years, length of educational program, and the administrative capability and financial responsibility of the applicant institution.

The review by the Department is nearly always conducted by reviewing documents. The institution completes the application and submits its most recent financial statement for review. Staff of the Department have worked with a number of accrediting commissions so that standards of the commissions would be similar to those of the Department. The standards that we ask the commissions to adopt mirror our own, so an institution that has been accredited would have a very good chance of being approved by ED for participation, since the standards for accreditation and certification are similar.

We will continue to aggressively pursue individuals who utilize the student aid programs to intentionally defraud the Federal government and the American taxpayer. Our debarment and suspension, and accountability regulations, as well as a much more thorough certification review, are effective tools which will be useful in tightening up the system and denying participation to individuals such as those associated with this particular institution.

50. Aaron Cohen, the former president of United Education and software, a major loan servicer which was shut down after findings of inadequate due diligence and inaccurate record keeping, has recommended that the Department review and approve loan servicers in the same fashion it reviews the administrative capability and performance of guarantee agencies. Do you believe that the Department should play a role in reviewing and approving loan servicers? Does the Department have any plans to implement such a process?

A. The holder of a Guaranteed Student Loan that contracts with a servicer is responsible for compliance with applicable program laws and regulations. Although a lender, secondary market, or guarantee agency may contract its day-to-day servicing operations to a private contractor, it has not, by doing so, legally assigned those loans to the servicer. The Secretary regulates the activities of lenders and guarantee agencies and specifies audits and reviews of those entities to ensure compliance. In our view, since the holder of the loan is responsible for any failure of its agent, there is no need to directly regulate the activities of the agent. This is why the Federal government refused to pay millions of dollars in the UES situation. If the Department did approve a servicer as a program participant, there would be serious legal ramifications in determining a penalty if that servicer later failed to adequately exercise due diligence on the loan.

This does not mean servicers are never reviewed by the Department or guarantee agencies. In the course of conducting reviews of lenders or guarantors, access to records frequently necessitates a collateral review of the servicer. Deficiencies of the servicer will be noted in the report, and its clients must require corrective action, or the clients may terminate the servicer's contract. In this way, the competitive nature of the marketplace will favor those servicers whose actions protect their clients from liabilities.

51. United Education and Software grew from servicing approximately $2 million in student loans in 1983 to servicing approximately $1.2 billion in student loan in 1988. However, the subcommittee staff found that the company had neither the staff nor the systems in place to handle this growth. Indeed, a 1988 review of UES ultimately concluded that "UES has demonstrated no ability whatsoever to service loans in accordance with federal regulations." UES's former president, Aaron Cohen, recommended that loan servicers be limited to a specific volume of loans based on their performance record and/or their in-place capability. Do you believe that such a limitation would be advisable?

A. We do not believe it would be advisable for the Department to limit Guaranteed Student Loan (GSL) programs loan servicers to a specific volume of loans. As previously stated, the holder of a GSL that contracts with a servicer is responsible for compliance with applicable laws and regulations. The lender is responsible for ensuring that a servicer is capable of handling the lender's loan volume before executing a contract and for monitoring the servicer's ongoing performance. Prior to a lender executing a contract with a servicer, the lender should examine the past performance and capacity of the servicer as key factors in evaluating the servicer's capability. If the servicer fails to adequately service a lender's portfolio, the lender is responsible. Improperly serviced loans would lose reinsurance and therefore result in no cost to the Federal Government.

52. The Inspector General testified that many servicers are reviewed by guarantee agencies with whom they are affiliated, thereby creating a potential conflict of interest situation. Do you see a potential conflict of interest in such a situation? What, if anything, does the Department do to prevent conflicts of interests in these and other aspects of the student loan program?

A. We do view potential conflicts of interest within the student loan community as a serious problem. For example, we proposed that the Omnibus Reconciliation Act of 1990 include a provision on guarantee agency officer restrictions. If this provision had been passed, guarantee agency officers, employees, and their immediate family members could not have a direct financial interest in any contractor or servicer with whom the guarantee agency does business. If program reviews identify such conflicts of interest, we would take immediate and forceful action against any entity involved.

53. Are there regulations governing potential conflicts of interests among schools, lenders, loan servicers, accrediting agencies, guarantee agencies, secondary markets, and other participants in the student loan program? If not, should there be?

A. The Department's current regulations at 34 C.F.R. 682.212 prohibit certain transactions between schools, lenders, and secondary markets that would represent a conflict of interest and would be inconsistent with the proper administration of the Guaranteed Student Loan (GSL) programs. In addition, 34 C.F.R. 602.16(g) requires accrediting agencies to maintain effective controls against conflicts of interest and against inconsistent application of their standards and criteria.

The Department monitors potential conflicts of interest among GSL program participants during program reviews and other evaluations of program participants. As mentioned in question 52, the Department views potential conflicts of interest within the student loan community as a serious problem, and proposed that the 1990 budget reconciliation bill contain a provision prohibiting guarantee agency officers, employees, and their immediate family members from having a direct financial interest in any contractor or servicer with whom the guarantee agency does business.

54. In the FITCO case, a major issue was the lack of origination fees paid to the Department by the trust company. Can we be assured today, that all other institutions involved in Title IV are current in origination payments? How was this problem rectified?

A. The Guaranteed Student Loan programs NPRM will continue the rule currently found in 34 CFR 682.304(a)(4) specifying that the selling and purchasing lender are jointly and severally liable for payment of the origination fee to the Secretary. We are also going to issue a "Dear Colleague" letter reminding purchasing lenders that they are responsible for payment of the origination fee if the selling lender does not pay it. In addition, we have several administrative activities that are designed to ensure payment of origination fees:

- A deactivation notice is sent to a lender who does not submit an interest and special allowance billing form for four quarters. The deactivation notice also directs the lender to submit any unpaid origination fees;
- The Department identifies lenders for review by assigning points for late filing of interest and special allowance billings;
- Special computer software is now in place to identify under-reported origination fees through review of the lender's interest and special allowance billings.

55. In the case of FITCO, someone in the Department was aware as early as 1985 that origination fees were not being paid in a timely manner, but not until 1988 did the Department actively pursue these payments. Why did it take ED three years to take action?

A. It did not take the Department three years to take action in the FITCO case. Rather, the Department took action that was timely and appropriate to the situation.

Origination fees must be reported on the lender's billing for interest and special allowances, at which point they are deducted from the interest and special allowances due. The Department bills the lender if a balance is due the Department.

FITCO was first delinquent in paying origination fees in 1985. The Department notified FITCO of the delinquency, demanded full payment of the overdue funds, and required assurances that the situation would not be repeated. FITCO complied with these requirements.

FITCO remained current in paying origination fees until early 1987. At that time, FITCO was billed $197,748 for fees it owed. In March, 1987 our regional office was instructed to monitor FITCO's billings. When FITCO fell behind in 1988, the Department promptly informed FITCO that all overdue origination fees must be paid immediately. FITCO requested an extended repayment schedule, but the Department refused to negotiate, noting that despite FITCO's prior assurance, this was a recurrence of a previous failure.

FITCO was closed by the California State Banking Department before we were able to recover the outstanding fees. We have been negotiating with the California State Banking Department to secure payment of FITCO's origination fees.

56. Time after time FITCO was ordered to pay origination fees which were in arrears, but never was any adverse action taken against them. Why?

A. Two guarantee agency reviews conducted between mid-1988 and FITCO's May, 1989 collapse reported that the agency was in arrears in filing its billings for interest and special allowances and for reimbursing the Department for origination fees in excess of the billing. The Department followed up by promptly informing FITCO that all overdue origination fees must be paid immediately. The Department's demand for payment, coupled with FITCO's cash flow problems due to the low quality of its loan portfolio and the collapse of its secondary market, prompted California state banking officials to close FITCO.

The statute provides that origination fees are to be deducted from Interest Base and Special Allowance Payments. See section 438(c)(1) of the HEA. Thus, the law, and the Department's system design, anticipated that interest and special allowances would always exceed loan origination fees. This is, in fact, the case with nearly all lenders. Therefore the Department's system was designed to offset interest payments against origination fees.

Now that the Department has seen the consequences of an operation such as FITCO, the Department has refined its system in two ways:

- A lender who has not submitted an interest and special allowance billing for four successive quarters will have his account suspended.
- Beginning on January 1, 1991, accounts more than 180 days delinquent will be billed for interest on the amount due.

It should be noted that many eligible lenders do not make loans for periods of time, or they make loans only sporadically. In these situations, there is no reason to submit a billing to the Department unless periodic bills are submitted for small interest payments. Therefore, the absence of a bill, by itself, is not viewed as a problem.

Finally, the calculation and payment of origination fees is an area reviewed during on-site lender reviews by the Department and guarantee agencies.

57. **Should guarantee agencies be permitted to terminate their agreements with lenders and schools on the basis of their default rates?**

A. **A guarantee agency may consider a school's default rate in determining whether a school should continue to participate in the agency's program. However, the default rate is not, by itself, a sufficient basis for the agency's termination of the school unless evidence of the school's lack of administrative capability exists, and therefore requires a limitation, suspension, or termination (L,S, or T) action to be imposed. However, the agency may require the school to take reasonable and appropriate measures to reduce defaults by its students as a condition for continued participation in its program.**

As you know, the Omnibus Budget Reconciliation Act of 1990 provides the Secretary with the authority to terminate a school's participation in the Guaranteed Student Loan programs based on a specified threshold for each of the three most recent fiscal years. These actions, based on fiscal year 1987, 1988, and 1989 cohort default rates, will commence July 1, 1991 against schools with rates of 35 percent or more.

In addition, Departmental regulations (34 CFR 668.15(b)(1)) provide the Secretary with the authority to initiate an L,S, or T action to terminate a school's eligibility from all Title IV student assistance programs if the school's fiscal year default rate exceeds 60 percent (this rate is to be lowered to 40 percent in increments of 5 percent by 1995), or if the rate exceeds 40 percent and has not been reduced by an increment of at least 5 percent from the preceding year's default rate. The Secretary will initiate such actions based on fiscal year 1989 cohort default rates, which will be available June 1, 1991.

58. Is it necessary to have 58 guarantee agencies operating in the student loan programs? Could several regional agencies handle the volume? Would several agencies provide more uniformity and efficiency to the programs? Would oversight of lenders or collection of defaulted loans be adversely affected?

A. There are several advantages and disadvantages, respectively, for a state-by-state guarantee agency system, or for a regionally-based system.

In the past, the Department and Congress have encouraged the development of state-based guarantee agencies, primarily because such agencies can develop close relationships with the state's lenders and student borrowers. Some of the responsiveness of a state-based guarantee agency could be lost in a regionally-based system. Further, a state-based system is conducive to the type of healthy competition that results in improved services for students, lenders, and schools. In its recommendations for the FY 1990 budget reconciliation bill, ED proposed that each state and jurisdiction give its "full faith" and backing to a designated guarantee agency. This would give greater stability to the guarantee system, and would foster state interest in the success of the guaranteed loan program.

On the other hand, arguments can be made that the presence of 58 guarantee agencies leads to redundancy and is confusing to students, lenders, and schools. For example, we are aware of the practices of some schools and lenders who attempt to negotiate and bargain for the best "deals" among agencies. Although some schools and lenders (and agencies) may benefit, these activities are not always the best "deals" for the students and Federal taxpayers. A smaller number of guarantee agencies could decrease costs and the multiplicity of agency policies and procedures that now exist and simplify the Department's administration of the GSL program.

This is an important issue that will receive careful attention during the reauthorization of the Higher Education Act.

59. We heard from lenders, servicers and guarantors that the Title IV program is over-regulated, too micro-managed. On the other hand, we heard from the field, for example in California that there are only 8 program personnel overseeing 14 states; that includes 11 guarantee agencies, 14 secondary markets, and 729 lenders. Do you see the over-regulation? Are these legitimate concerns?

A. We do not believe this program is over-regulated or micro-managed. Given the level of abuse that has been found, particularly by our Inspector General, the current level of our regulations is not unreasonable. Most of the requirements under this program are aimed at reducing defaults and preventing fraud, waste, and abuse.

In terms of staffing for program monitoring, we have about 300 program office staff to oversee approximately 17,500 lenders, institutions, and guarantee agencies. Our Inspector General staff of 330 FTE focuses 75 percent of its attention on student aid programs. We also have regulations requiring guarantee agencies to monitor lenders and institutions. In addition, we require institutions of higher education receiving Federal funds to have non-Federal audits every two years.

60. The Department has issued waivers to the New Mexico guarantee agency regarding collection of delinquent loan (due diligence) requirements. What is so unique about the New Mexico agency and can it be used as a model elsewhere?

A. The New Mexico Student Loan Guarantee Corporation (NMSLGC) has a policy of litigating against delinquent borrowers before they enter default. The Department has authorized NMSLGC to amend its promissory notes to permit litigation prior to default and granted certain waivers of the due diligence in collection provisions for holders and guarantee agencies in order for the New Mexico program to be implemented. A number of factors combine to make the NMSLGC litigation program effective in that State. A principal factor is that virtually all loans guaranteed by NMSLGC are held and serviced by the state secondary market in New Mexico, the New Mexico Education Assistance Foundation, once they enter repayment. The guarantee agency and the secondary market work closely together, sharing the same attorney, in the litigation program. The secondary market files all collection suits in the same courthouse, as provided for under New Mexico law. Special terms of the Guaranteed Student Loan programs promissory notes also provide for proper venue to file suit at this single location. This greatly simplifies procedures and forms. Additionally, since the district court system is unified in New Mexico, and each court has statewide jurisdiction, it is possible to enforce judgments filed in Albuquerque throughout the state. Because the entire litigation process is so centralized, a single part-time lawyer and small clerical staff are able to handle all litigation in New Mexico with minimal expense. Moreover, to facilitate such litigation, the State legislature has authorized the New Mexico program to defer payment of court filing fees until they are recovered from the borrowers.

This program could be implemented in other states, with the cooperation of the various state legislatures. However, those states with multiple holders of student loans would find it significantly more difficult to implement such a program.

61. How much do the Department's program compliance officials rely on the Inspector General's office for program compliance support? Do the Department program compliance officials have an independent audit section?

A. The Department's compliance program for student financial assistance has several major components:

1) The Office of Student Financial Assistance (OSFA) has about 200 staff in ten regional offices involved in on-site program compliance reviews at participating schools, lenders and guarantee agencies. The Division of Audit and Program Review (DAPR), OSFA, provides guidance and direction to these review activities.

   In addition, DAPR is responsible for resolving all independent CPA audits of schools and guarantee agencies. Schools and guarantee agencies are required by regulation to have an independent audit every two years. A similar requirement is being proposed for large dollar volume lenders.

2) Since 1987, all guarantee agencies have been required to conduct compliance reviews of their high default schools and lenders. Reports on these reviews are sent to DAPR and the appropriate regional offices. Guarantee agencies generally act independently on their findings and assess liabilities or initiate administrative sanctions as appropriate. In many cases, joint administrative actions are taken with the Department. The guarantee agencies conduct about 1,200 to 1,400 reviews annually.

3) The Office of the Inspector General (OIG) has auditors and criminal investigators who conduct audits and investigations. In recent years, over 75 percent of the OIG's resources have been devoted to student financial assistance activities. The OIG refers cases to OSFA for administrative action or recovery of liabilities.

62. Do your program review employees have any criminal investigative experience or training to enable them to recognize fraud when they conduct school, lender, or loan servicing reviews?

A. Our program review staff generally do not have any criminal investigative background or training. Their primary function is to review institutions, lenders, and guarantee agencies to determine compliance with program policy, procedures, regulations, and legislation. When, in the course of conducting a program review, a staff member suspects fraud, the case is immediately referred to the Inspector General's office for follow-up. The IG has criminal investigators with the background and training to pursue these types of cases.

63. In regard to the FITCO/UES fiasco, it has been described as the "greatest failure" to occur in the Title IV program. How many investigators does the Department have assigned to the case? What office are they assigned to?

A. Many people within the Department have worked on the FITCO/UES problem as part of their ongoing responsibilities. The Office of Postsecondary Education, with primary responsibility for overseeing FITCO, does not have "investigators" in the sense of individuals trained in criminal investigative techniques, although numerous staff have covered the situation.

The Office of Inspector General (OIG) performed audits related to FITCO refunds, collection of loan origination fees, and administration of Title IV programs at UES schools. The OIG expended considerable resources, auditors and investigators, in analyzing the UES problem. Three senior OIG officials were assigned directly to this effort over a six to eight month period.

UES' loan servicing failure represents the largest loan servicing failure to occur in the Title IV program. However, UES' loan servicing problems were not the result of inadequate oversight by the Department or the guarantee agencies. In fact, the Department has devoted a great deal of time to resolving this situation and protecting the taxpayer's interests.

UES' servicing problems began in late 1987 and were detected in early 1988 by three guarantee agencies during claims processing. On-site reviews by the guarantors and ED staff in the summer of 1988 confirmed the existence of major problems at UES. The Department then took prompt action in August 1988 to suspend reinsurance on the UES-serviced loan portfolio. The Department stood firmly behind its established cure procedures for ineligible loans, despite intensive efforts by the lender to obtain a more lenient cure. Over $80 million of loans with falsified collection histories were deemed ineligible for cure. The lender has had to absorb this cost as well the costs of loans that could not be cured and the expenses of cleaning up the loan servicing deficiencies.

The Department's handling of this case has had significant impact throughout the GSL lending community. Overall, we believe there is a much greater awareness of loan servicing requirements and their importance. Many lenders have engaged their own reviewers and auditors to monitor their loan servicing operations. The loss of a loan's guarantee presents a very great risk to a lender. Consequently, we believe that private incentives will help ensure that, in addition to the ongoing compliance efforts of the Department, another UES-type loan servicing problem does not occur.

64. Have your employees been directly involved -- on the scene -- with FITCO-in-liquidation company to determine what went wrong, why, how, who is accountable and also determine the extent of the damage done to individual accounts?

A. ED employees have been very involved in the FITCO liquidation process. We have worked closely with officials from the California State Banking Department who are responsible for the liquidation. These officials have the primary responsibility for assessing damages to individual accounts.

The Department believes that one of the primary reasons for FITCO's collapse was FITCO's dependence on the student loan program as its primary business activity. FITCO became an eligible lender as the result of special legislation authorizing FITCO to make student loans its primary consumer credit function. (See section 435(d)(1)(A)(ii)(III) of the Higher Education Act of 1965.)

FITCO's business strategy was to make loans and then immediately sell the loans to a secondary market. In this way, FITCO did not have to service the loans. FITCO used trust funds for the initial loans and received income from transfer fees for selling loans to secondary markets and the sale of loans in excess of par value. This strategy was successful until FITCO's access to a secondary market collapsed.

When FITCO's secondary market (primarily the California Student Loan Finance Corporation) stopped purchasing its loans, FITCO experienced a severe cash shortage and could not meet its commitments. Since FITCO never serviced loans to any extent, FITCO began to have problems servicing its unmarketable portfolio. FITCO's situation continued to decline until the California State Banking Department began liquidation procedures.

65. When a school closes, does anyone in the Department review the student financial aid files at the school to determine if any liabilities exists?

A. When the Department receives notice or determines that a participating education institution has ceased operation, lost accreditation, filed for bankruptcy, or is expected to cease participation in Title IV programs, a regional office program reviewer is designated to act as the Lead Officer in handling the school's closure.

The Lead Officer routinely performs the following tasks:

1. If possible, establishes contact with the school to obtain pertinent information and provide instructions for an orderly close-out of Federal student financial aid programs;
2. Promptly notifies ED officials in the Central Office, e.g., the Division of Eligibility and Certification so appropriate action can be taken;
3. Develops plans to recover Federal funds from the school, its banks, or other repositories; pick up records and related documents; obtain documentation for collection of Letter of Credit/Performance Bond funds; and identify major liabilities; and,
4. Carries out the planned tasks and ensures that the target dates for completion of the closed school procedures are met.

If the school is not fulfilling its close-out obligations, such as obtaining a closeout audit, the Lead Officer will establish liabilities for any unaccounted funds and any outstanding GSL/Stafford refunds owed to lenders.

66. These problems are not confined to the GSL programs. What are you doing to assure the Pell and other financial aid programs are being strengthened?

A. Although much attention is given to the negative effects of student loan defaults, we recognize that Pell grants given to students at institutions of poor financial capability or educational quality are just as serious a problem and a drain on the Federal treasury. Therefore, we are working to ensure that all student aid program funds are being managed with integrity in a way that will benefit students.

To help reach this goal, the Department has issued proposed regulations to improve accountability in the student aid programs. These regulations will prevent owners who cause their schools to go out of business because they misused student aid funds from gaining control or influence over other legitimate schools participating in Title IV programs. The regulations will also help the Department collect otherwise uncollectible liabilities of closed schools by requiring participating schools to assume responsibility for those liabilities if the participating schools seek to absorb the closed schools as eligible branch campuses. The regulations will strengthen penalties on schools that have a history of failing to file audit reports. The regulations will also prohibit the use of funds intended for postsecondary education for remedial education at the elementary or secondary level except for English as a Second Language.

The Department has proposed regulations to curb the practice under which schools, through the arbitrary use of credit hours, qualify for eligibility and increase the amount of aid to students by artificially increasing the apparent length of educational programs without increasing the actual amount and quality of the education offered. By mandating, for student aid purposes, a formula to determine the number of hours of class attendance in vocational programs represented by each credit granted, the Department would be able to eliminate such abuses as (1) 8-week programs that represent themselves to students and the Department as 6-month programs, and (2) circumstances in which students receive two full Pell Grants and 2 maximum Stafford loans for pursuing the equivalent of only one year's worth of education.

The Department has published proposed regulations that would, in final form, improve control over cash flow problems in the Pell Grant Program by reducing the time-frame in which, following the close of an award year, a school must report and return excess Pell Grant funds to the

Department. These regulations would also require schools to report more promptly to the Department changes in students' enrollment or other status that affect the amounts of their awards, in order to ensure that the amount of Pell Grant funds provided to schools more accurately reflects the amount actually needed and that excess amounts are available for use by other schools.

The Department is developing proposed regulations to curb practices under which certain categories of schools contrive to avoid the application of the statutory requirement that they must have been in existence for two years before participating in the student aid programs. Under these practices, some owners of new schools arrange for their schools to become branches of existing eligible schools for two years and, having satisfied the two-year requirement, establish those branches as free-standing schools that qualify for immediate eligibility in their own right. Other eligible schools create networks of branches whose financial stability rests solely on the presumption of the immediate availability of Title IV aid. The Department will propose regulations that would impose two-year waiting periods for student aid in these circumstances, thus enabling the Department to assess the viability of schools to operate branches without excessive dependence on Federal financial support.

67. Schools with default rates above 20 percent must develop and submit default management plans that address the causes of default. How many schools has the Department requested submit such management plans? How many of these schools have actually submitted the default management plans? What action will be taken against those schools who fail to submit the required plan? Does any one at the Department review these plans and assure that the plans are implemented?

A. Based on the FY 1987 cohort default rates, 1188 schools were required to submit default management plans. All but 22 of these submitted plans. The Department imposed the measures listed in Appendix D of the June 5, 1989 default reduction regulations on those 22 schools that failed to submit plans. The plans approved or imposed based on the FY 1987 rates are in effect for three years unless the schools' rates change so that they are no longer required to be covered by a default management plan.

When the cohort default rates for FY 1988 were released, an additional 584 schools were identified as having to submit default management plans. 114 of these did not submit plans and had the measures of Appendix D imposed on them. We are now researching why they did not submit plans.

We have determined, for example, that one group of schools did not submit plans because they were not aware that they were required to do so. These schools submitted plans based on their FY 1987 rates but, because those plans were not required (the schools had rates under 20 percent, fewer than 30 borrowers entering repayment, etc.) no action was taken on their plans. When the schools were notified that they were expected to file plans based on their FY 1988 rates, many thought that the plans submitted previously would be considered and did not submit new ones. After being notified that the Department was imposing the Appendix D measures, many of the schools requested that we consider their earlier plan as their submission. For other schools, no action was necessary because their earlier submission included all of the measures in Appendix D.

A school's compliance with its approved (or imposed) default management plan is examined during the course of the normal program reviews conducted by both the Department of Education and guarantee agencies. This is a fairly new activity since the first approval cycle for institutional default management plans did not end until March 1990. However, the program reviews that have included a review of the default reduction efforts of schools indicate that most are implementing their plans as approved. When non-compliance is discovered, schools are cited and required to take corrective action.

68. I understand that the cohort default rate is determined by the number of students from a school whose loans go into repayment in a given year and the percentage of those students whose loans go into default. This is obviously a very valuable tool. Yet, I am informed that the 1988 cohort rate is in error. What mistake was made in calculating the rate? What specific erroneous results will this have on schools and the Department? How much will this mistake cost the Department?

A: The FY 1988 default rates were calculated correctly; however, there was an anomaly in the calculation due to an unusual situation involving improper servicing of some loans. These loans were those that were serviced by United Education Software for the California Student Loan Finance Corporation primarily to students attending schools in California. The loans in fact entered repayment during the fiscal year 1988 and were correctly counted in the denominator of the fraction used to calculate default rates for the affected schools. However, because of processing irregularities, the payment of default claims was suspended pending a determination of the status of the loans. As a result, some defaulted loans were not counted in the numerator of the calculation and the default rates calculated for these schools may have been understated.

When this situation was brought to the attention of the Department, we immediately sought legislative authority to recalculate the default rates for those schools whose former students loans were affected. The authority to exclude the loans in question from both the numerator and the denominator was included in S. 580, which was signed by the President on November 8, 1990 (P.L. 101-542). As soon as such authority is enacted, we will recalculate the FY 1988 rates for those schools. Until the recalculation is completed, we will not know the impact of this anomaly, but, we do not expect it to be great.

69. Should the Department publish a list of default rates for lenders?

A. The Department does use lender default rates, among other indicators, to assist in targeting lenders for review. However, the Department does not believe that there is any purpose to be served by publishing a list of default rates for lenders. Unlike a school default rate, a lender default rate does not necessarily reflect the quality of the administrative work done by a lender since many lenders sell their loans to a secondary market as soon as they are made. In fact, more than 25 percent of the outstanding student loans are held by the Student Loan Marketing Association. Due to the rapid turnover in student loan paper, attributing defaults to the actions of lenders is not especially reliable.

70. Some have testified that some level of defaults by students is inevitable, given the nature of the constituencies the loan programs are intended to serve. Where the disagreement occurs is over what constitutes an acceptable percentage in this regard. Do you agree that some defaults are inevitable and, if so, what is the percentage level you think is acceptable?

A. We have targeted the bulk of Departmental regulatory requirements at schools experiencing the highest default rates. While some defaults are likely to occur in any loan program, we do not consider any specific percentage of defaults as "acceptable." Many schools serving low-income students have low loan default rates. There is no reason why a high-default school cannot reduce its default rate.

71. When a guarantee agency submits a claim for reinsurance, does the Department analyze the claim and its supporting paperwork?

A. No. Guarantee agencies do not submit the individual student loan files to the Department when requesting reinsurance. Instead, they submit a form that summarizes the amounts paid to lenders on insurance claims as well as the amounts due to the Department for the Secretary's Equitable Share of Collections on defaulted loans. The Department reviews these forms for the reasonableness of the amounts requested. The Department relies on post-payment reviews and audits to determine whether individual claims are valid.

72. What kind of administrative penalties or fines is the Department able to use against problem schools, lenders or guarantors? In the past year, for example, how often have administrative penalties been assessed? If fines are not workable, what needs to be changed? How many have you assessed in the last 2 years? How much money have you collected in fines and penalties? Please list these.

A. The Department has authority to fine, limit, suspend or terminate institutions and lenders in addition to assessing liabilities against these institutions for regulatory violations. The Department also has authority to initiate emergency actions against schools and to fine guarantee agencies. Attachment 1 shows the number of administrative actions taken from Fiscal Year 1982 to 1990.

During the past two years, the Department has significantly increased the use of its fine authority to penalize schools for regulatory violations, particularly the failure to submit required biennial CPA audits. Attachment 2 shows the dollar amount of fines assessed and collected during the past two years.

Fines against lenders and guarantee agencies are a particular problem because of statutory restrictions on the Secretary's authority. The statute provides that the Secretary can fine a lender or guarantee agency up to $25,000 per violation or substantial misrepresentation. The statute further defines a single violation as a pattern or practice covering multiple violations. Thus, even in an egregious case, such as falsification of collection activities, the Department could only fine a lender $25,000 for the "practice" of falsification. The statute also prohibits the Secretary from imposing a fine if the lender or guarantee agency cure or correct a violation.

Question 72, Attachment 1 November 4, 1990

OFFICE OF STUDENT FINANCIAL ASSISTANCE

SUMMARY OF ADMINISTRATIVE ACTIONS

	FY 90	FY 89	FY 88	FY 87	FY 86	FY 85	FY 84	FY 83	FY 82
TERMINATIONS INITIATED(1	53	30	27	14	13	14	10	17	26
TERMINATIONS EFFECTED(2)	18	16	10	1	5	3	4	4	10
DISQUALIFICATIONS (3)	7	6	2	New authority NOV 1986					
SUSPENSIONS	0	2	0	0	1	0	0	0	0
LIMITATIONS/SETTLEMENTS	17	5	8	2	8	6	12	13	15
EMERGENCY ACTIONS (4)	0	1	9	2	2	2	4	3	7
FORMAL FINES (imposed)	27	13	7	3	4	3	4	10	5
INFORMAL FINES (paid)(5)	215	194	106	81	34	21	28	23	15
REIMBURSEMENT SYSTEM (6)	192	126	52	13	19	19	15	27	28
DEBARMENT/SUSPENSIONS(7)	58	24	New authority OCT 1988						

(Footnotes on next page)

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Question 72, Attachment 1

FOOTNOTES

SUMMARY OF ADMINISTRATIVE ACTIONS

[1] Includes actions in process, actions canceled due to school closure/loss of eligibility and actions withdrawn as a result of corrective actions and/or settlement agreement.

2 Includes terminations imposed, schools that lost eligibility or closed after termination action was initiated, and actions resolved by settlement agreement.

3 Disqualifications have the same effect as terminations but are based on actions taken by Guarantee agencies. They apply only to the Guaranteed Student Loan programs.

4 The Secretary's authority to take emergency action was successfully challenged in court in FY 1989. In November 1989, Congress gave the Secretary authority to publish emergency action regulations. These regulations became effective on September 21, 1990. No actions were completed prior to September 30, 1990; however, in October 1990, 17 emergency actions were taken.

5 Informal fines represent agreements reached with institutions without the need for a formal hearing process. The most common reasons for an informal fine are failure to submit audits and repeat violations. The total value of the 215 informal fines paid in FY 1990 was $621,267. The amount of the 194 fines paid in FY 1989 was $2,187,180.

6 Although not a formal administrative action, schools are transferred to the reimbursement system of payment when there is suspected fraud or abuse of program funds. Under the reimbursement system of payment, the school must submit proper documentation of student awards to receive payment.

7 In October 1988, Government-wide procedures for non-procurement debarment and suspension became effective. The majority of cases completed to date involve individuals who have been convicted or indicted for abuse of the SFA programs.

Question 72, Attachment 2

Fines Assessed and Collected

FY 1990

	Assessed No.	Assessed Amount	Collected No.	Collected Amount
Formal	27	$1,308,500	Unavailable	
Informal	329	$31,042,027	205	$621,267

FY 1989

	Assessed No.	Assessed Amount	Collected No.	Collected Amount
Formal	13	$ 3,347,000	Unavailable	
Informal	265	$ 5,960,117	194	$ 2,187,180

73. Program participants complain about the "constant and frequent" changes in the Title IV program. I know you cannot control the amendments made by the Congress, but you are responsible for regulations and for "Dear Colleague" letters, which we are told, you send to program participants. Can you comment on this?

A. Although we agree that the Title IV programs, particularly the Guaranteed Student Loan programs, have undergone frequent changes in recent years, the majority of these changes have resulted from statutory changes to the program. Of course, statutory changes usually require subsequent regulatory changes. In addition, we have issued special regulations, such as our Default Initiative regulations, to address program abuses. Many of our Dear Colleague letters are to inform program participants of these statutory and regulatory changes. A large number of our "Dear Colleagues" do not address programmatic changes; rather, they inform program participants of reporting or application procedures required for their participation in the Title IV programs. We do not believe that the number of our regulatory initiatives or Dear Colleague letters has been excessive.

74. Has the Department recently instituted an amnesty program that would excuse penalties on defaulted student loans as well as erase damage to credit ratings? Is this program currently ongoing? What has been the response? Did the Department actively promote it?

A. The Department instituted a "special payoff program" in response to the requirements of Public Law 101-239 (Omnibus Budget Reconciliation Act of 1989), signed by the President on December 19, 1989. This program expired on August 31, 1990. The Department is currently analyzing the response to the program and expects to have statistics reflecting its outcome available in December, 1990. The Department actively promoted the program through public announcements in the media, direct mailings to individual defaulters, and "Dear Colleague" letters to guarantee agencies.

75. Why should the taxpayer subsidize "education" for occupations that are in relatively low demand in our economy? Do you feel it is appropriate to funnel billions of dollars in Government-guaranteed loans to pay for a host of travel agents, dog groomers, cosmetologists, and card dealers? Is it feasible to use industry-based needs projection and Department of Labor job projections in some sort of analysis to determine the Nation's needs and to project student aid accordingly?

A. We think that the Federal government should not use projections of employment demand by specific occupations to limit educational choices. Because of variations in local and regional demand for specialized training, national estimates would rarely be more than rough guidelines and would frequently be misleading for a given area. In regional reauthorization testimony, for example, we heard of significant demand for truck drivers in a certain region of the country even though there is indication of an excess supply at the national level. Furthermore, the dynamic nature of the economy results in frequent shifts in demand for occupational specialties by specific industries and smaller businesses.

We agree, however, that it is not appropriate to provide large amounts of aid to students who have no reasonable prospect of obtaining employment related to their training. Reliable placement data are the best indicators of local and regional employment demand for different types of training as well as indicators of institutional quality. These data can be used by States to enhance their own consumer protection programs, especially their examination of schools' advertising claims of employment opportunities. That is why our default reduction regulation introduced requirements for vocational programs to provide prospective students with data on placement rates for those who have recently completed training and sought employment. However, Congress, as part of the "Student Right-To-Know Act," recently suspended until July 1993 the Department's regulations requiring institutional disclosure, to prospective students in vocational programs, of the withdrawal rate of the institution and other information that could help prospective students in deciding whether to enroll.

76. In addition to assuring that the education offered is related to the Nation's needs, shouldn't we also set reasonable limits on the amount of Federal student aid offered for various courses of instruction? Could we not set that limit based on the cost of a similar course at a public institution? Do you think we could, using Department of Labor data, estimate the potential earnings in a trade and then formulate a ceiling on the aid available to individual students studying for that trade?

A. Our investigations have often found that some relatively expensive courses offered by for-profit institutions are offered much more cheaply by nearby public community colleges. Because public college tuitions reflect a large implicit subsidy, these cost differences are not always as large as they may appear to be. Furthermore, proprietary schools sometimes offer lower-cost or higher quality programs. Nevertheless, we think that prospective students cannot make an informed choice about postsecondary education training unless they have detailed comparative cost and performance information. That is why we emphasized consumer information in our default reduction regulations. As noted in Question #75, Congress recently suspended this requirement.

We oppose student financial aid ceilings based on projections of potential earnings of trade school graduates. Individual earnings depend on general business cycles, fluctuating local and regional prosperity for particular types of businesses, the quality of training provided by particular schools and the talent and determination of individual students. To include all of these factors in an "average earnings" formula would be impractical. For example, in a certain region, there may a high demand for a particular job skill, where in other regions that job skill may be in low demand. An "average earnings estimate" could yield a low student aid formula that does not accurately reflect the region's high demand and higher rate of pay for the skill. Such a circumstance could undermine programs that charge higher prices to provide quality training and genuine employment prospects.

77. We have received a letter from a State official in which the official emphasizes that proprietary school accrediting bodies are "like rabbits guarding lettuce." He says the problem is not that the accrediting bodies "are in bed with the schools they approve. It is more simply that they are the schools." Do we need this system at all? What guarantee of quality has it given us? Have we not abdicated a Federal responsibility to private concerns?

A. We are very concerned about the quality of education provided by schools, but the Department is limited by statute in the extent of its direct control over the area of educational quality; see, e.g., 20 U.S.C. 1232a and 3403(b). The determination of quality of education has always been primarily the responsibility of the accrediting agencies and States.

However, we are acting within the boundaries of our statutory authority to address the problem of quality. This includes: carefully reviewing accrediting agencies policies before re-approving them; encouraging State licensing bodies to become more involved in overseeing school operations; drawing attention to the importance of outcome measures to schools such as default, graduation, job placement and licensure rates; and, providing students with information to assist them in making informed choices before enrolling in a particular school. The Department also recently suspended a number of for-profit trade schools, utilizing the emergency action regulations which were authorized in the Budget Reconciliation Amendments of 1989 (P.L. 101-239).

We expect the issue of strengthening accrediting agency and State licensure standards to receive full attention during the HEA reauthorization.

78. We do not question your motives or your willingness to change the Department of Education's oversight of the student aid participants. However, we do believe that the problems may require a new internal structure to properly carry out the needed changes. Would you be adverse to an independent management audit of the entire Department of Education? Would you be willing to lead the subsequent internal reforms? Do you think that the program needs an Assistant Secretary position to elevate the issue to its proper level? Do you believe that the Department should have an Office of Enforcement to clamp down on program abuse and to free up the Inspector General's Office?

A. I am not averse to an independent management audit of the entire Department. In fact, the General Accounting Office (GAO) is working with us to establish parameters under which they will conduct a study of our Department management. In addition to the GAO study, I have asked the Office of Management and Budget (OMB) to collaborate with the Department in a management review of our Guaranteed Student Loan Program. I will be personally involved with any internal reform that is necessary to improve upon our management of these programs and in monitoring the efforts of the studies outlined above.

At this time, I do not believe the student aid programs need an Assistant Secretary level position. Once these studies are completed, we will be able to better answer that question and your additional questions.

79. It costs less than $2.00 to run a credit check with a national credit bureau. Do you think borrowers should pay for this service to assure that people with an adverse credit history not receive carte blanche guaranteed student loans?

A. Yes. We have proposed legislation requiring a lender to perform a credit check on all borrowers aged 21 and older, at the borrower's expense (not to exceed twenty-five dollars). Such a borrower is likely to have established a pattern of repayment on other financial obligations which provides the lender with a basis for determining the probability of repayment of a guaranteed student loan. Further, we would recommend that a co-signer be required for those applicants for whom a credit check reveals a negative credit history. However, we would not recommend a co-signer be required if the applicant's credit check showed either a positive or no credit history.

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80. Is there any reason we should not require guarantee agencies to submit delinquent loans to the IRS for offset and skip tracing before submitting the loan to the Department of Education for a reinsurance claim?

A. Guarantee agency loans cannot be submitted to the Department of Education (ED) and then to the IRS for offset before reinsurance claims are paid. Debts submitted to the IRS for offset must be debts owed the United States. Guarantee agency defaulted loans are the property of guarantee agencies when they pay lender claims. Guarantee agency loans can become the property of ED only after ED pays reinsurance claims and the loans are assigned to ED, not before.

Delinquent guarantee agency loans are routinely submitted to the IRS for address update, prior to the time loans are submitted to ED for reinsurance claims. There is no IRS requirement that the loans be the property of the United States to get an address update.

81. Should not all schools offer a pro-rata refund policy to all students? Why limit this requirement to schools with high default rates.

A. The Department examined this issue in promulgating its June 5, 1989 default reduction regulations. In determining that the application of a *pro rata* refund policy should apply only to high default schools, we noted that there was a linkage between a high level of dropouts at an institution and resulting defaults. The prospects for default are clearly greater for students who withdraw early in their programs and the intent of the *pro rata* refund requirement is to remove any incentive for a school to enroll a student lacking a reasonable prospect of completing his or her program of study. Therefore, we believe that such a refund policy should be required only when the default experience of the school dictates such an action to protect students and the taxpayers.

82. Shouldn't we require all schools and lenders to forward and post refunds and loan cancellations to borrowers' accounts within 30 days, and levy monetary fines for those that fail to comply?

A. Many institutions, especially public State colleges and universities, have experienced administrative difficulty in complying with a 30-day timely refund requirement. These difficulties most often result from computer delays, the involvement of more than one institutional office in the refund process, and, for many State institutions, the role of State treasurers' offices in the generation of refund checks. As a result of these problems, the Department revised the time frame for a timely refund to a lender in the June 5, 1989 Default Reduction Regulations to be 60 days after the earliest of 1) the student's withdrawal date, 2) the expiration of the academic term, 3) the expiration of the period of enrollment for which the loan was made, or 4) the date on which the school determines that the student has withdrawn. A deadline of 30 days was retained only for those students who failed to return to school following an approved leave of absence. We believe that 60 days provides institutions with a reasonable amount of time to resolve unexpected delays and comply with Federal Regulations. An institution that violates the timely refund provision is required to repay any interest and special allowance paid by the Department beginning on the 61st day. The Division of Certification and Program Review does propose informal fines against an institution for repeated violations of the timely refund provision and may recommend that the "Participation Control Branch" limit or terminate an institution's eligibility to participate in the Title IV programs.

The GSL program regulations, 34 CFR 682.209(e), require a lender to "promptly" credit refunds to student accounts. The Department has not acted to define "promptly" nor regulate this area more closely since there is no evidence of abuse by lenders. Should evidence of such abuse be uncovered, the Department will regulate further in this area.

Questions Submitted to Secretary Cavazos from Senator William V. Roth

83. Please provide answers to the following questions separately for four-year institutions, community colleges, and proprietary schools.

   A. What is the average completion rate?
   B. What is the average job placement rate?
   C. What is the average percentage of total revenue derived from Title IV programs?
   D. What is the average percentage of enrolled students who receive student financial aid?

If the Department of Education does not have sufficient data to fully answer these questions, please provide the best estimates from the data that is available.

A. Some of the specific data requested in this question are not readily available. However, in response to the request, we are providing the best data available that shed light on these issues. This entails using data from a variety of sources. Because different data sets were collected at different times and for different reasons, they are not always consistent in terms of the time frames they cover or the way they distinguish among postsecondary institutions. (In each instance, however, we used the most recent data available.) Therefore, included in each response is a brief description of data sources and important considerations to be kept in mind when analyzing these data.

A. Average completion rate

Program lengths vary considerably. Bachelor's degrees, which are awarded by four-year institutions, typically take the longest to complete (approximately four years). Associate degrees, granted predominantly by community colleges, require approximately two years to complete. Certificate programs, which proprietary schools generally offer, range widely in length from several months to approximately two years. These differences must be kept in mind when comparing completion rates across different types of institutions and educational programs.

The data presented below are taken from a sample of students who were high school seniors in 1980 (these data are "time censored" in that they are limited to individuals who were

H.S. seniors in 1980; in other words, there is no consideration of older, "non-traditional" students). The percentages represent the status in 1984 (four years later) of students who enrolled in each of the three types of institutions. Given the relatively short time period elapsed compared to the length of time required to complete the educational programs, many of the 1980 high school graduates may have been making progress toward a degree in 1984 without having completed their educational program; this is especially likely for students attending part-time. Given these circumstances, analyses using these data must consider not only the percentage of students who have received a degree or certificate, but also the percentages of students still enrolled in school, those who have transferred, and those who have left postsecondary education without receiving a degree or certificate (i.e., "dropped out"). These data are presented below.

	4-YEAR INSTITUTION	COMMUNITY COLLEGE	PROPRIETARY SCHOOL
RECEIVED DEGREE OR CERTIFICATE	29.8%	19.1%	36.1%
STILL IN SCHOOL	24.4	13.8	8.6
TRANSFERRED	26.6	25.2	13.2
LEFT POSTSECONDARY EDUCATION	19.3	42.0	42.2

SOURCE: U.S. Department of Education, National Assessment of Vocational Education, Second Interim Report from the National Assessment of Vocational Education, September 1988.

B. Average job placement rate

Employment rates for students who have completed an educational program are not available for four-year colleges.* We do have unemployment rates for students in the high school class of 1980 who subsequently attended postsecondary institutions and took at least 15 percent of their course work in vocational subjects. (The unemployment rates represent the percentage of students in each institution type that experienced one or more periods of unemployment between March 1985 and February 1986). The simple arithmetic equation of 100 minus the unemployment rate yields the following approximate employment rates.

However, it should be noted that these figures do NOT indicate the percentage of students who obtain employment in the area of their training, which may be a better indicator of how an institution has succeeded in giving its students marketable job skills.

	4-YEAR INSTITUTION	COMMUNITY COLLEGE	PROPRIETARY SCHOOL
EMPLOYMENT RATE	N/A	83.0%	73.7%

SOURCE: U.S. Department of Education, National Assessment of Vocational Education, Postsecondary Vocational Education, Final Report, Volume IV, 1989.

C. Average percent of revenue from Title IV

There is no information readily available on the percentage of revenue institutions receive from Title IV funds. However, the figures below represent Pell Grant revenue as a percentage of institutions' current fund revenue in 1985-86. Data are presented separately for the public and private sectors and for two-year and four-year institutions. Data are not available for proprietary schools, which are more reliant on federal funds than other types of institutions. Public and private two-year institutions are typically those whose highest level of offering is a two-year degree. In the public sector, two-year colleges are generally community colleges. In the private sector, about half of all two-year institutions are organized as profit-making; the other half are non-profit (many are church-affiliated).

	INSTITUTION TYPE			
	4-YEAR PUBLIC	4-YEAR PRIVATE	2-YEAR PUBLIC	2-YEAR PRIVATE
PELL GRANT REVENUE AS % OF CURRENT FUND REVENUE, 1985-86	2.3	1.6	5.6	13.1

SOURCE: U.S. Department of Education, National Center for Education Statistics, Digest of Education Statistics, 1989, Table 267. p. 290.

D. Percent of students who receive aid

The table below shows the percentages of students receiving aid who were enrolled in the fall of 1986, by institution type. Data separate institutions by sector: public or private. Within the four-year category, data distinguish between doctoral granting universities ("doc") and other institutions offering four-year (bachelor's) programs ("4 yr"). Non-baccalaureate institutions are divided according to program length of the highest level offered: two-year ("2 yr") or less-than-two-year ("<2 yr"). In the table below, data presented for non-baccalaureate private institutions apply exclusively to students attending for-profit institutions.

	INSTITUTION TYPE	
	ALL 4-YEAR	LESS-THAN-4-YEAR
TOTAL AID	46.8 (Pub Doc)	28.5 (Pub 2 yr)
	47.3 (Pub 4 yr)	51.8 (Pub <2 yr)
	61.8 (Pri Doc)	82.7 (Pri 2 yr)
	67.9 (Pri 4 yr)	84.8 (Pri <2 yr)
FEDERAL AID	35.5 (Pub Doc)	19.9 (Pub 2 yr)
	38.4 (Pub 4 yr)	41.9 (Pub <2 yr)
	45.7 (Pri Doc)	79.2 (Pri 2 yr)
	50.1 (Pri 4 yr)	81.4 (Pri <2 yr)

SOURCE: U.S. Department of Education, National Center for Education Statistics, Undergraduate Financing of Postsecondary Education: A Report of the 1987 National Postsecondary Student Aid Study, June 1988.